

# INTERNATIONAL COPYRIGHT PIRACY: A GROW- ING PROBLEM WITH LINKS TO ORGANIZED CRIME AND TERRORISM

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## HEARING BEFORE THE SUBCOMMITTEE ON COURTS, THE INTERNET, AND INTELLECTUAL PROPERTY OF THE COMMITTEE ON THE JUDICIARY HOUSE OF REPRESENTATIVES ONE HUNDRED EIGHTH CONGRESS FIRST SESSION

MARCH 13, 2003

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## **INTERNATIONAL COPYRIGHT PIRACY: A GROWING PROBLEM WITH LINKS TO ORGANIZED CRIME AND TERRORISM**

**THURSDAY, MARCH 13, 2003**

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON COURTS, THE INTERNET,  
AND INTELLECTUAL PROPERTY,  
COMMITTEE ON THE JUDICIARY,  
*Washington, DC.*

The Subcommittee met, pursuant to call, at 9:10 a.m., in Room 2141, Rayburn House Office Building, Hon. Lamar Smith [Chairman of the Subcommittee] presiding.

Mr. SMITH. The Subcommittee on Courts, the Internet, and Intellectual Property will come to order.

I'm going to recognize myself and the Ranking Member for opening statements, and we'll certainly put the opening statements of all other Members, without objection, into the record. And after that, we'll move immediately to our witnesses and look forward to hearing their testimony.

Today, the Subcommittee will conduct its second hearing on copyright piracy. The first hearing addressed peer-to-peer copyright infringement on university campuses. The Subcommittee now will examine the extent of international copyright piracy and whether there are links between this activity and organized crime and terrorism.

The rise of the Internet and new digital media has changed the way that the public enjoys entertainment products, including music and movies. One of the advantages of digital formats, such as CDs and DVDs, is that they offer extremely high-quality reproduction of audio and video. A major disadvantage is that digital formats make the works very susceptible to piracy. Since every digital copy offers a perfect reproduction, these works are easily copied and distributed over the Internet on a global basis.

Last year, American copyright-based industries suffered more than \$9 billion worth of piracy-related losses in 56 countries. Half of those losses affected the music industry. In fact, there was one pirated music product for every three sold worldwide.

In 2000, the annual seizure of pirated discs for the Motion Picture Association was 1.9 billion units. By the close of 2002, it was up to 6.1 billion units. In just 2 years, the annual piracy rate had increased five times.

In some places, such as Asia and parts of the former Soviet Union, pirated software accounts for nearly 90 percent of the soft-

were used. At the close of 2002, for example, seizures of pirated Microsoft products alone exceeded \$1.7 billion.

The copyright industries drive the engine of the American economy. Exports and foreign sales of U.S. copyrighted products total \$100 billion, which helps the national balance of trade. Copyrighted works are a result of American creativity. When properly commercialized, these works lead to jobs, profits, and a more enjoyable quality of life for us all.

There is good reason why the Founders embraced the concept of intellectual property protection. They realized that if creators cannot gain from their creations, they will not bother to create. And actors and writers and composers and singers cannot gain if their work is stolen. Would any other American industry be able to sustain its operations for long if a third of its sales were lost to theft?

A recent article in *Time* Europe noted that an average drug dealer pays \$47,000 for a kilo of cocaine with an estimated street value of \$94,000, which yields 100 percent profit. For the same \$47,000 investment, a pirate could buy or produce 1,500 pirated copies of Microsoft's Office 2000 professional software and resell it for a profit of 900 percent.

In other words, the overhead for pirating copyrighted material relative to other illegal economic activities is minimal, the profits are exceptional, and the relative risk level of attracting the attention of law enforcement officials is low. Well, low risk and high profit is how criminals view piracy.

In the end, it really doesn't matter whether the pirates are individuals or crime organizations. One thing is clear. Their activity is rising, and it must be addressed.

That concludes my opening statement, and now I'll recognize the Ranking Member, Mr. Berman of California, for his.

Mr. BERMAN. Well, thank you, Mr. Chairman. And I want to commend you for putting together the third week, the third straight fine hearing, and I appreciate your scheduling this and organizing it.

And I particularly want to thank you for inviting Joan Borsten Vidov to testify. She's a constituent of mine, and she's been a friend for a very long time, a very long time. She brings a valuable perspective to the hearing, that of an American entrepreneur whose business has been dramatically impacted by a foreign government's sustained campaign to steal her rights to intellectual property.

Because we usually hear about copyright piracy from large corporations or celebrities, we often lose sight of the impact that piracy has on individual American entrepreneurs or copyright owners.

While Internet—international hard goods piracy may seem a dull subject to some, it is a critical issue to U.S. copyright holders. The aggregate hard good piracy losses suffered by U.S. copyright industries in foreign nations are pretty astounding. You've mentioned some of the figures. You talked about 56 countries. I have an estimate that it probably equals \$20–\$22 billion annually worldwide, not including Internet piracy.

Individual foreign countries—China, \$1.85 billion; \$770 million in Brazil; \$800 million in Italy; \$757 million in Taiwan; and \$756 million in the Russian Federation. Another interesting statistic—93

percent of business software sold in China, 47 percent of music sold in Taiwan, 80 percent of movies sold in the Russian Federation were pirated.

In 2001, 99 percent of entertainment software sold in Brazil was pirated, while, in 2002, 55 percent of entertainment software sold in Italy was pirated.

As piracy percentages climb in a particular nation, it becomes increasingly difficult for U.S. copyright owners to establish a legitimate market. In some cases, as with entertainment software in Brazil, U.S. copyright owners have had to abandon the market entirely. They simply can't justify the expense of maintaining a presence in a nation where the demand for their copyrighted works is almost entirely met by vastly cheaper pirated versions.

The piracy-related inability of U.S. copyright owners to access a legitimate market in many foreign countries results in real harm to the U.S. economy. The core copyright industries make a tremendous contribution to the U.S. economy, accounting for more than 5 percent of the U.S. gross domestic product. That's more than the deficit will be in about 5 or 6 years. [Laughter.]

Mr. BERMAN. How much greater would the contributions to the U.S. economy be if U.S. copyright owners could access foreign markets otherwise dominated by pirate product? Our Microsoft witness will speak to some real numbers, but I do want to remark on his estimate that in 2008, software piracy will cost the U.S. \$1.6 billion in lost tax revenue.

These numbers and percentages can seem dry, and their sheer size sometimes begs skepticism. And that's why Joan's presence today, I think, is so important. Her personal story of intellectual property theft by the Russian government provides a context to these numbers, just as she provides a face for U.S. victims of international copyright piracy.

I don't want to steal her thunder, but I want to highlight a couple of the issues that I think her particular situation represents. In Joan's case, the theft of her intellectual property rights is not some private syndicate operating in distant shadows within a foreign government, but it is the foreign government itself—the Russian Federation government.

Through the establishment of dummy corporations, fraudulent license transfers, and illegal pressuring of Russian courts, the Russian Federation government has attempted to deprive Joan of her valid license to copyrights for a library of Soviet era animation.

Where a foreign government is itself stealing intellectual property from a U.S. citizen, it is particularly appropriate for the U.S. Government to demand that the foreign government stop the theft. Conversely, it would be entirely inappropriate for the U.S. to grant any special trade privileges, such as WTO accession or GSP benefits, to a foreign nation whose government is stealing intellectual property from a U.S. citizen.

I know your particular focus, Mr. Chairman, is on the links between organized crime, terrorism, and this international piracy. In that regard, I wish to note that intellectual property theft by a government represents the very essence of organized crime.

In any nation, there is typically no bigger organization than its government and no greater power. Thus, when the government

steals intellectual property, it is engaging in organized crime of the highest magnitude.

I thank you again, Mr. Chairman, for scheduling the hearing and yield back.

[The prepared statement of Mr. Berman follows in the Appendix]

Mr. SMITH. Thank you, Mr. Berman.

Let me introduce our witnesses today. Our first witness is the Honorable John G. Malcolm, currently a deputy assistant attorney general in the Criminal Division of the Department of Justice, where his duties include overseeing the Computer Crime and Intellectual Property Section, the Child Exploitation and Obscenity Section as well, the Domestic Security Section, and the Office of Special Investigations.

An honors graduate of Columbia College and Harvard Law School, Mr. Malcolm served as a law clerk to judges on both the United States District Court for the Northern District of Georgia and the 11th Circuit Court of Appeals.

Our next witness is Rich LaMagna, who is the senior manager of worldwide investigations at Microsoft, where he manages global anti-piracy investigations. In this capacity, he provides policy and operational guidance to members of the Microsoft worldwide anti-counterfeiting team.

Mr. LaMagna received his B.A. from Gettysburg College in 1970 and a master's of arts in liberal studies from Georgetown University in 1996. He is a graduate of the Foreign Services Institute in Chinese and French studies and is fluent in Cantonese, Mandarin, and French.

Our next witness is Jack Valenti, who is president and chief executive officer of the Motion Picture Association of America. Born in Houston, Texas, Mr. Valenti became a highly decorated serviceman while serving in the Army Air Corps in World War II. In 1952, he co-founded the advertising political consulting agency of Weekley & Valenti.

He is perhaps best known, however, for his service as a special assistant to President Johnson from 1963 to 1966. On June 1, 1966, Mr. Valenti resigned his White House post to assume the helm at MPAA. He has a B.A. from the University of Houston and an MBA from Harvard.

Our last witness is Joan Borsten Vidov, who is president of Films by Jove, Inc., a California-based film production and distribution company, which acquired in 1992 worldwide rights to most of the award-winning animation library of Moscow's Soyuzmultfilm Studio.

Ms. Borsten received her B.A. in comparative literature from the University of California at Berkeley and her M.S. in bilingual education at USC.

Welcome to you all. Without objection, your entire written testimony will be made a part of the record. I would ask you all to try to keep your comments within the 5 minutes allotted. But we very much look forward to hearing from you all today.

And Mr. Malcolm, we'll begin with you.



**STATEMENT OF JOHN G. MALCOLM, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, UNITED STATES DEPARTMENT OF JUSTICE**

Mr. MALCOLM. Thank you, Mr. Chairman. I'll try to abide by the time limits you set.

Mr. SMITH. Turn on your mike. Is it—

Mr. MALCOLM. There we go. Okay.

Mr. Chairman, Members of this Committee, thank you for inviting me to testify today. I am pleased to offer the Justice Department's views on the links among organized crime, terrorism, and intellectual property piracy.

The focus of this hearing is extremely important, and I commend you, Mr. Chairman, for your attention to this issue. At the outset, I would like to take this opportunity to acknowledge your considerable and consistent support of law enforcement during your distinguished tenure as Chairman of this Committee. You've played a vital role in many cybersecurity issues, and the department is, indeed, grateful for your support.

The strong enforcement of intellectual property laws is a priority for the Department of Justice, and with the assistance of this Subcommittee, we will continue to wage an aggressive battle against piracy in the months and years ahead.

As you know, Mr. Chairman, with Congress's generous support, Attorney General Ashcroft has established 13 Computer Hacking and Intellectual Property (or CHIP) units across the Nation. These specialized units, which are comprised of dedicated Federal prosecutors whose primary focus is on prosecuting high-tech crimes, including intellectual property crimes, help the Justice Department to keep pace with the rapidly changing face of high-tech crime.

The establishment of these specialized units ensures that individuals who misuse technology to further criminal activity will not find a safe haven in the United States.

Congress also allocated resources that have allowed the department to significantly increase the size of the Criminal Division's Computer Crime and Intellectual Property Section, or CCIPS, as it's more commonly known.

Intellectual property protection is one of CCIPS's core responsibilities. CCIPS now has a deputy chief whose sole responsibility is to oversee and manage 10 attorneys within the section who are dedicated to IP enforcement. These attorneys are developing a focused and aggressive long-term plan to combat the growing threat of piracy.

As my written testimony outlines, Mr. Chairman, the Justice Department has achieved many significant victories as of late against IP pirates. One of those cases is Operation Buccaneer. To date, over 20 convictions have been attained in this ongoing investigation of online international piracy groups. The sentences in these cases have been the longest ever imposed for online piracy, ranging from 33 to 46 months imprisonment.

Just yesterday, CCIPS, working with the CHIP unit in the eastern district of Virginia under the able stewardship of U.S. attorney Paul McNulty, indicted Hew Raymond Griffiths, a leader in some of the most well-known online piracy groups around the world. Griffiths, whose screen name was Bandido, directed the actions of

many of the defendants I mentioned before who have already been convicted and sentenced.

Over the course of the past 2 years, while Operation Buccaneer systematically dismantled the criminal organizations he managed and incarcerated many of the people he supervised, Mr. Griffiths remained in Australia, seemingly beyond the reach of U.S. law enforcement. However, the department will seek to extradite Mr. Griffiths for criminal prosecution.

The decision to extradite Griffiths for his role in intellectual copyright piracy should send a strong signal around the world. For too long, people engaged in piracy have believed that if they were outside the borders of the United States, they could violate our intellectual property laws with impunity. They're wrong.

This indictment and the extradition sends a clear and unequivocal message to everybody involved in illegal piracy that, regardless of where you are, the Justice Department will find you, investigate you, arrest you, prosecute you, and incarcerate you.

In the battle against piracy, international cooperation is essential, and Operation Buccaneer has been precedent setting in this regard. Indeed, U.S. law enforcement continues to support its counterparts in the United Kingdom, Sweden, Finland, and Norway, who are investigating individuals in those countries in connection with this ongoing operation. Our commitment to strong intellectual property rights enforcement will not stop at our borders.

Mr. Chairman, piracy today is big business—a worldwide, multi-billion dollar illicit economy, which robs legitimate industries and creators of income, while driving up the costs to consumers. Not surprisingly, criminal organizations are playing a more prominent and dangerous role in piracy around the globe.

My written testimony describes two different, yet equally troubling types of criminal organized activity that are emerging globally—organized online piracy groups, such as the one run by Mr. Griffiths, and traditional organized crime syndicates operating primarily from Asia to Eastern Europe.

While it's true that online piracy or warez groups do not fit squarely within the definition of organized crime used by the department, they are nonetheless responsible for placing a massive number of pirated movies, music, games, and software into circulation each year and represent a significant and growing threat to intellectual property rights around the globe. They specialize in being the first to release new pirated software to the warez community for unauthorized and unlimited reproduction and distribution.

These online groups are extremely security conscious, often utilizing the latest technology to hide their illegal operations. Like legitimate companies, top-tier warez groups have clear hierarchies and divisions of labor. Rank and position within warez groups are based on a variety of factors, including special skills, length and quality of service to the group, and reputation within the warez scene.

A typical group—which consists of people all around the world who may know each other only by their screen names—will consist of one or two leaders, two or three high-level individuals known as council, 12 to 15 staff members, and a general membership comprising anywhere from 20 to 80 individuals.

The more work somebody does for the group, the higher within the organization that person will move, and the greater access that person will have to pirated material.

What's surprising to many, Mr. Chairman, is that online piracy groups typically don't engage in piracy for monetary gain. That having been said, it would be a grave mistake to dismiss their conduct as harmless or unimportant.

On the contrary, most of the pirated movies, music, games, and software available on the Internet come from these high-level warez groups. And further, they are the source for much of the pirated products which filter their way down to less sophisticated, but more widely used distribution mechanisms, such as peer-to-peer networks.

While the pirates who steal and distribute software do not profit monetarily, the consequences to the victim companies are just as dire as if they did. For many victim companies, particularly smaller companies whose livelihood depends upon the success of only one or two products, irreversible damage occurs the moment the pirated digital copy hits the Internet.

Among emerging concerns is the fact that traditional organized crime syndicates appear to be playing a dominant role in the production and distribution of certain types of hard goods piracy, such as optical disks. This problem seems particularly prevalent in Asia and parts of the former Soviet Union. Unlike warez groups, the goal of these organized crime groups is to make as much money as they possibly can.

Highly organized criminal syndicates pose special challenges for law enforcement because they have significant resources to devote to their illegal operations, thereby increasing the scope and sophistication of their activity. They control international distribution channels, which allow them to move massive quantities of pirated goods, as well as any other illicit goods, throughout the world.

These groups will not hesitate to threaten or injure those who attempt to interfere with their operations. Throughout Asia, organized crime groups operate assembly lines and factories that generate literally millions of pirated optical discs. These groups pirate a full range of products, ranging from music to software to movies to video games. Anything that can be reproduced onto an optical disk and sold around the globe is available.

Mr. SMITH. Mr. Malcolm, we're 7½ minutes into your testimony, and I'm only half way through your written statement. I'm getting concerned.

Mr. MALCOLM. I apologize. Actually, I only had two more paragraphs, but I'll be happy to yield and would be happy to answer your questions.

[The prepared statement of Mr. Malcolm follows:]

#### PREPARED STATEMENT OF JOHN G. MALCOLM

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me to testify before you today. This is an extremely important topic, and I commend you, Mr. Chairman, for holding this hearing. This hearing and the others recently held by the Subcommittee are providing the American public with an important look at the growing threat of intellectual property (IP) crime, which chiefly includes copyright piracy, trademark counterfeiting, and theft of trade secrets. Today I am pleased to offer the views of the Department of Justice on the links among organized crime, terrorism and intellectual property piracy.

## THE DEPARTMENT OF JUSTICES ANTI-PIRACY PROGRAM

The enforcement of this nation's criminal laws protecting intellectual property is a priority at the Department of Justice. Since the beginning of his tenure, Attorney General Ashcroft has worked diligently to ensure that the prosecutorial resources needed to address intellectual property crime are in place. Shortly after becoming the Attorney General, he used additional resources provided by Congress to establish or expand Computer Hacking and Intellectual Property (or CHIP) Units in ten U.S. Attorney's Offices across the nation. These specialized units consist of dedicated federal prosecutors whose primary focus is on prosecuting high tech crimes, including IP crimes. Subsequently, the Attorney General established three additional CHIP units, and used additional funding to bolster the cyber and IP prosecutive resources in a number of other jurisdictions. The CHIP units ensure that the Department of Justice has a ready supply of prosecutors to pursue IP cases. The expertise of the various CHIP Units helps the Justice Department to keep pace with the changing face of high-tech crime. Rapid advances in technology bring new challenges to the investigators and prosecutors who handle these cases, and the establishment of these specialized units ensures that the individuals who misuse technology to further their criminal activity will not find a safe haven in the United States.

The CHIP Units complement the already existing network of Computer and Telecommunications Coordinators (CTCs) that serve in every United States Attorney's Office. The CTCs regularly receive specialized training in the investigation and prosecution of high-tech crimes, including intellectual property crimes. Many of the 94 U.S. Attorneys Offices have two or more CTCs to help meet the growing demand for trained high-tech prosecutors.

Working hand-in-glove with the CHIP Units and the CTC network is the Criminal Divisions Computer Crime and Intellectual Property Section, also known as CCIPS, which I supervise. Created as a Unit in 1991 by then-Assistant Attorney General Robert Mueller and elevated to a Section in the Criminal Division in 1996, CCIPS is a highly specialized team of over thirty-five lawyers who focus exclusively on computer and intellectual property crime. CCIPS attorneys prosecute cybercrime and intellectual property cases; advise and train local, state, and federal prosecutors and investigators in network attacks, computer search and seizure, and IP law; coordinate international enforcement and outreach efforts to combat intellectual property and computer crime worldwide; and comment upon and propose legislation. For example, CCIPS attorneys worked with Congress, including Members of this Committee, in 1997 to improve IP enforcement through the legislative amendments made by the "No Electronic Theft" (NET) Act. Those amendments extended federal criminal copyright law to unlawful large-scale reproduction and distribution of copyrighted works even when the thieves do not make a profit. In 1999, CCIPS prosecutors obtained the first convictions after trial under the Economic Espionage Act of 1996, a criminal statute that protects trade secrets. CCIPS also worked with the U.S. Sentencing Commission in 2001 to amend the sentencing guidelines to provide substantial sentences for copyright infringement.

With the deeply appreciated support of Congress, we have significantly increased the size of the Computer Crime and Intellectual Property Section in the past eighteen months, which is allowing us to devote additional resources to address piracy both here and abroad. Intellectual property protection is an important part of my portfolio, and a core responsibility of CCIPS. Moreover, for the first time, CCIPS has a Deputy Chief whose sole responsibility is to oversee and manage the attorneys in the Section dedicated to IP enforcement. At present, there are ten CCIPS attorneys working full-time on the IP program. The attorneys of CCIPS are developing a focused and aggressive long-term plan to combat the growing threat of piracy. They are developing and implementing the Departments overall anti-piracy strategy, assisting AUSAs in the prosecution of intellectual property crimes, and reaching out to international counterparts to ensure a more effective world-wide response to intellectual property theft. Working in concert, CCIPS, the CTC Network, and the CHIP Units create a formidable, multi-pronged approach to prosecuting intellectual property crimes. We are already beginning to see the positive results of their efforts.

## SIGNIFICANT PROSECUTORIAL ACCOMPLISHMENTS:

In the past few years we have achieved many significant prosecutorial victories against IP pirates. I would like to take just a few minutes to highlight some of our most recent accomplishments.

*Operation Buccaneer:*

The Computer Crime and Intellectual Property Section, working with the CHIP Unit for the Eastern District of Virginia and the United States Customs Service, continues to investigate and prosecute a massive international copyright piracy conspiracy code-named "Operation Buccaneer." This undercover investigation culminated in the simultaneous execution of more than 70 searches worldwide in December 2001, including searches in Australia, Finland, Sweden, Norway, and the United Kingdom. It was the largest Internet software piracy investigation and prosecution ever undertaken, and the first to reach across international borders to achieve coordinated enforcement action against domestic and foreign targets. The investigation targeted multiple top-tier, highly organized and sophisticated international piracy or "warez" groups that specialized in "cracking" the copyright protection on software, movie, game and music titles and distributing tens of thousands of those titles over the Internet. I will discuss their organized criminal operations in more detail shortly.

As a result of Operation Buccaneer, as of today, *twenty* U.S. defendants have been convicted of felony copyright offenses, sixteen of those in the Eastern District of Virginia. Nine defendants have received prison sentences of between 33 to 46 months, the longest sentences ever imposed for Internet copyright piracy. Six defendants are awaiting trial in the United Kingdom, and I can assure you with virtual certainty that more prosecutions will be brought in the U.S. as this investigation progresses. In both its scope and outcome, Operation Buccaneer is the most significant Internet piracy case ever brought, and it has sent a strong deterrent message which continues to resonate throughout the copyright piracy community.

*United States v. Mynaf:*

On February 13, 2003, a California man, Mohsin Mynaf was sentenced in the Eastern District of California to 24 months in federal prison for multiple violations relating to copyright, including Digital Millennium Copyright Act violations, criminal copyright infringement, and trafficking in counterfeit labels. Mynaf operated a videocassette reproduction center which produced counterfeit movie videocassettes, which he would then sell at various locations throughout California. In addition to 24 months in federal prison, Mynaf must also pay in excess of \$200,000 in restitution. Three other individuals have also been convicted of aiding and abetting Mynaf in his illegal activity and are awaiting sentencing. This case was successfully prosecuted by a CTC in the U.S. Attorneys Office in Sacramento, California.

*Operation Decrypt:*

On February 11, 2003, in the Central District of California, as part of a year-long investigation known as Operation Decrypt, 17 individuals were indicted for their roles in developing sophisticated software and hardware used to steal satellite television signals. One of the individuals has already pled guilty and admitted to being responsible for nearly \$15 million in losses to the victim companies. An additional nine defendants have also agreed to plead guilty to various crimes as a result of their involvement. The defendants in these cases used online chat rooms to exchange information and techniques on how to defeat the sophisticated security protections utilized by satellite entertainment companies. In October of 2002, search warrants were executed in seven states as part of this operation. Operation Decrypt is being prosecuted by an attorney with the CHIP Unit for the Central District of California, located in Los Angeles.

*United States v. Ke Pei Ma, et. al:*

On February 26, 2003, in a joint operation between federal and local law enforcement in New York City, four arrests were made and six people were charged (two remain fugitives) in conjunction with an investigation of the illegal distribution of Symantec and Microsoft software. At the time of the arrests, over \$9 million worth of counterfeit software was seized from distribution centers in the New York area. The defendants are believed to have distributed thousands of copies of counterfeit software and received an estimated \$15 million over two years in return for the pirated products. In a single two-month period, the defendants received nearly \$2 million dollars as a result of their illegal activity. This case was prosecuted by attorneys in the CHIP Unit in the Eastern District of New York.

*United States v. Rocci:*

Beginning on February 25, 2003, the Computer Crime and Intellectual Property Section, working with the CHIP Unit for the Eastern District of Virginia, engaged in a ground-breaking and highly-successful public education effort as part of a conviction originally obtained in December of 2002. In December, David Rocci of Virginia, pled guilty to conspiring with others to traffic in illegal circumvention devices

in violation of the Digital Millennium Copyright Act. Rocci was the owner and operator of the most prominent publicly-accessible web site on the Internet dedicated to providing information about the “warez” scene and copyright infringement, *www.iSONEWS.com*. Rocci used his web site as the exclusive medium to conduct the illegal sale of circumvention devices known as “mod chips,” which defeat security protections in the Microsoft Xbox and allow unlimited play of pirated games on the gaming console. As a condition of his guilty plea, Rocci transferred his domain name and website to the United States. Upon taking control of the domain name late last month, the United States replaced iSONEWS.com with a new web page providing information about U.S. v. Rocci, as well as a general anti-piracy message outlining the potential criminal consequences for engaging in illegal piracy. (A copy of the website is attached to this testimony.) This case marks the first time that the United States has assumed control of an active domain name in an intellectual property case. In the first three days, the new law enforcement site received over 238,000 hits from Internet users worldwide. As of March 11, the two week mark, the site received over 550,000 hits. The Department feels a strong sense of responsibility to educate the public about the need to respect intellectual property rights and will look for additional opportunities like this to build upon successful prosecutions of those who willfully violate those rights.

Mr. Chairman, as you can see, the Department of Justice is actively pursuing intellectual property criminals engaged in a wide array of illegal activity, and we are doing so using all of the various statutes at our disposal. Our efforts are beginning to pay off, and we are having success in our battle with global piracy. But we are not resting on our laurels and are aware that there is much work to be done. We remain committed to this effort and will build on our success by continuing to prosecute piracy aggressively.

#### ORGANIZED CRIMINAL ACTIVITY AND PIRACY:

As a result of cases such as those I have just mentioned, law enforcement today has a deeper and more sophisticated understanding of piracy than it has ever had before. Piracy is a continually evolving crime. Traditionally, piracy operations were small, often run by individuals or a loose collection of people trying to make a quick buck in what has been perceived to be a fairly “risk-free” criminal enterprise. However, in recent years, that has changed. Piracy is now big business: a world-wide, multi-billion dollar illicit economy which robs legitimate industries and creators of income, while driving up costs for consumers.

It is against this backdrop that criminal organizations are playing a more prominent—and dangerous—role in piracy around the globe. Organized criminal activity, in many forms, is clearly a factor in global piracy today. Today, I will talk about two different, yet equally troubling, types of organized criminal activity that are emerging globally: organized on-line piracy groups and traditional organized crime syndicates operating from Asia or Eastern Europe.

#### ORGANIZED ON-LINE PIRACY GROUPS:

One aspect of piracy—practically non-existent as recently as twenty years ago—is online or Internet piracy. The Internet has changed the landscape of intellectual property crimes in many ways. Piracy over the Internet poses significant challenges for law enforcement. It is harder to detect than traditional means of piracy, and it costs the pirates virtually nothing to operate, while generating countless perfect digital copies of music, movies, software and games in just a fraction of the time it would take to generate the copies manually. Even when we successfully remove the source of digital piracy, any copies previously distributed remain on the Internet and can spawn a whole new generation of pirated products with little more than a few strokes on a keyboard.

As mentioned, until recently, on-line piracy was believed to be high-return, low-risk endeavor by many in the piracy community. Now, however, through a number of high-profile enforcement actions, the Department is making it clear to members of the online piracy community that their activities may have dire consequences for them. In addition to Operation Buccaneer, attorneys from the Department, along with the Federal Bureau of Investigation, have effectively prosecuted online pirates in other cases, such as the “Pirates with Attitude” and “Fastlane” prosecutions in Illinois, and two ongoing prosecutions, “Operation Bandwidth” in Nevada and “Operation Digital Piratez” in New Hampshire. We are committed to continuing to disrupt the online piracy community. The word is out: the Department of Justice will pursue online pirates and will put them in jail.

The Department has learned a great deal about the online piracy community. First and foremost, it is dominated by a handful of highly structured, security con-

scious groups which exist solely to engage in piracy online. These organized criminal groups are frequently referred to as “warez” groups. While warez groups are a relatively new phenomenon, they are responsible for placing a massive number of pirated movies, music, games and software into circulation each year, and represent a significant and growing threat to intellectual property rights around the globe.

The leading international warez groups compete against each other to attain a reputation as the fastest, highest quality, free providers of pirated computer software, including utility and application software, PC and console games, and movies. These groups specialize in being the *first* to release new pirated software to the warez community for unauthorized reproduction and distribution. The groups prosecuted as part of Operation Buccaneer were among the most notorious organized online piracy groups in the warez scene.

These criminal organizations are extremely security conscious, utilizing state-of-the-art technology to attempt to shield their illegal activity from victim companies and from law enforcement. They are also highly organized, structured to maximize their manpower and technological know-how to fully and efficiently support their illegal activity.

Like legitimate companies, “top-tier” warez groups have clear hierarchies and divisions of labor. Rank and position within warez groups are based on a variety of factors, including special skills, length and quality of service to the group, and reputation within the warez scene. A typical group—which can consist of people all over the world who may know each other only through their screen names—will consist of one or possibly two leaders, two or three high level individuals known as “Council,” twelve to fifteen Staff members, and a general Membership comprising anywhere from twenty to eighty individuals. The Leader has ultimate authority over all aspects of the group and its activities. Council members are primarily responsible for the group’s day-to-day operations, including preparation of new releases, recruitment, and security issues. Staff members are typically the most active individuals in preparing a group’s new releases for distribution, or in maintaining the group’s “File Transfer Protocol” (FTP) sites from which the pirated software is distributed. Finally, the general Members contribute to the group in a variety of ways, including acting as occasional suppliers of new software, hosting the groups FTP servers, or providing hardware (e.g., laptops, hard drives, routers, other computer equipment) to other group members for use in their warez activities. The more work someone does for the group, the higher up the organization that person will move, and the greater the access that person will have to pirated products.

While there are countless similarities, two factors distinguish warez groups from traditional organized crime syndicates. First, warez groups conduct their illegal operations in the cyber world as opposed to the physical world. Second, and perhaps most startling, warez groups typically do not engage in piracy for monetary gain. In fact, in some quarters of the warez scene, pirates who engage in “for profit” operations are held in contempt and criticized.

Despite the fact that warez groups typically do not profit directly, it would be a grave mistake to dismiss their conduct as harmless or unimportant. On the contrary, warez groups pose a growing and significant threat to intellectual property rights holders around the world. It is generally agreed that most of the pirated movies, music, games and software available on the Internet come from these high-level warez groups. Further, they are the source for much of the pirated products which filter their way down to less sophisticated, but more widely used, distribution mechanisms such as peer-to-peer networks. For example, a warez group dedicated to music piracy will obtain unauthorized advance copies of songs and albums and distribute those advance copies to the warez scene. Within days, or frequently within just a few hours, the warez music release filters down to public “Internet Relay Chat” (IRC) channels and peer-to-peer networks—often weeks before its commercial release date. The availability of MP3 files on the Internet in advance of legitimate CD’s being made publicly available results in a direct injury to the artists and to the recording industry.

While the pirates who steal and distribute copyrighted works do not profit monetarily, the consequences to the victim company are just as dire as if they did. For many victim companies, particularly smaller companies whose livelihood depends upon the success of only one or two products, irreversible damage occurs the moment the pirated digital copy hits the Internet.

Any consideration of organized crime and IP must include top-level warez release groups. While we recognize that our efforts must address all aspects of online and hard-good piracy, including the pursuit of those involved in the lower tiers of the Internet distribution chain, the Department will continue to devote significant resources to pursuing warez groups.

## TRADITIONAL ORGANIZED CRIME AND INTELLECTUAL PROPERTY.

Another emerging concern is the fact that traditional organized crime syndicates appear to be playing a dominant role in the production and distribution of certain types of hard goods piracy, such as optical disks. This problem seems particularly prevalent in Asia and parts of the former Soviet Union. Unlike warez groups, the goal of these organized crime groups is to make as much money as they can.

The continued emergence of organized crime poses substantial challenges for law enforcement. Highly organized criminal syndicates frequently have significant resources to devote to their illegal operations, thus increasing the scope and sophistication of their criminal activity. Further, by nature, these syndicates control international distribution channels which allow them to move massive quantities of pirated goods, as well as other illicit goods, throughout the world.

As one might expect, these groups do not hesitate to threaten or injure those who attempt to interfere with their illegal operations. Industry representatives in Asia report that they have been threatened and their property has been vandalized by members of these syndicates when their anti-piracy efforts strike too near the illegal operation. Government officials have also been threatened. These criminal syndicates are a formidable foe, but one that must be dealt with to truly attack the problem of intellectual property theft.

Throughout Asia, organized crime groups operate assembly lines and factories that generate literally millions of pirated optical discs. These groups pirate a full range of products ranging from music to software to movies to video games. Anything that can be reproduced onto an optical disk and sold around the globe is available. There is also anecdotal evidence that syndicates are moving their production operations onto boats sitting in international waters to avoid law enforcement.

Recently, an attorney from the Computer Crime and Intellectual Property Section visited Kuala Lumpur, Malaysia to conduct law enforcement training for Malaysian prosecutors and agents. According to Malaysian officials with whom he spoke, many, if not most, of the optical disk production facilities in Malaysia are owned and operated by organized crime syndicates, specifically very wealthy and powerful criminal gangs or "triads" from Taiwan which control a significant number of facilities not just in Malaysia but across Asia generally.

The reach of organized crime appears to extend beyond the production of optical disks into the distribution chain. While in Malaysia, that same CCIPS attorney visited an open air market, similar to ones found in large cities around the world, which offered a myriad of pirated products. While touring the market, our attorney learned that many vendors offer their goods on tables covered in brightly colored cloths which indicate that vendors affiliation with a specific criminal syndicate. One vendor may use a red cloth to show his affiliation with one criminal gang, while his neighbor offers his wares on a blue cloth signifying his affiliation with another criminal gang.

Of course, this problem is not limited to Malaysia, but occurs in other parts of the world such as in parts of the former Soviet Union. Additionally, many organized piracy groups from Asia use South America, most notably Paraguay, as a transshipment point for pirated products. Industry groups have reported that organized crime from Taiwan and other parts of the world control much of the distribution of optical disks into Latin America through Ciudad del Este.

It is also true that the pirated goods produced by organized crime syndicates enter into and are distributed throughout the United States. There is ample evidence, for example, that Taiwanese triad members import into the United States massive amounts of counterfeit software and other counterfeit products, such as "remarked" computer chips. The reach of these organized crime operations is undeniably global in scope.

Of course, developing more and better intelligence about these organized crime groups and their operations is just the first step in what will be a long and potentially difficult process of targeting this type of activity. Because most of these syndicates operate outside the United States, we must rely on foreign governments for much of the enforcement efforts in this area. The importance of international co-operation cannot be overstated. If a government lacks the will or the expertise to enforce IP laws, organized crime will continue to proliferate with impunity. Even in countries that have the will and expertise to fight back, a lack of investigative resources, inadequate laws, a judicial system that will not impose serious sentences, or corruption can grind IP enforcement to a halt.

The Department of Justice is committed to being a constructive part of the United States government's international IP outreach efforts. In particular, we are focusing our resources on those foreign nations which face surmountable difficulties in the investigation and prosecution of IP crimes. We are pleased to be working with other



United States agencies, such as the Patent and Trademark Office, the State Department and the U.S. Trade Representative, to ensure that foreign nations are committed to building sound and lasting IP enforcement regimes.

The Justice Department will continue to work closely with investigative agencies, especially the Federal Bureau of Investigations and the United States Customs Service, to develop additional intelligence sources and information in order to enhance our ability to respond to the growing threat of organized crime from Asia and other parts of the world. This is a serious and emerging threat that victimizes American rights holders, costs companies hundreds of millions of dollars, and damages our nation's economy. There is no easy solution. The task at hand requires a concerted effort on the part of industry, government and law enforcement. The Department stands ready to do its part.

#### TERRORISM AND PIRACY

Finally, Mr. Chairman, I want to close by briefly discussing terrorism. Earlier I noted that organized crime syndicates are frequently engaged in many types of illicit enterprises, including supporting terrorist activities. On this point, I want to be crystal clear. Stopping terrorism is the single highest priority of the Department of Justice. We are constantly examining possible links between traditional crimes and terrorism, and we will continue to do so. All components of the Justice Department, including CCIPS, the Counterterrorism Section, and the Organized Crime and Racketeering Section, will do everything within their power to make sure that intellectual property piracy does not become a vehicle for financing or supporting acts of terror.

#### CONCLUSION

On behalf of the Department of Justice, I want to thank you again for inviting me to testify today. We thank you for your support over the years and reaffirm our commitment to continuing to work with Congress to address the significant problem of piracy. I will be happy to answer any questions that you might have.



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**NEWS RELEASE**

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**DEFENDANT INDICTED IN CONNECTION WITH OPERATING ILLEGAL INTERNET  
SOFTWARE PIRACY GROUP**

ALEXANDRIA, Va.- United States Attorney Paul J. McNulty and Michael Chertoff, Assistant Attorney General for the Criminal Division, announced today the indictment of Hew Raymond Griffiths, of Bateau Bay, Australia, on charges related to his leadership of one of the oldest organized software piracy groups on the Internet. The Department of Justice also announced that it intends to seek his extradition in the coming weeks.

A federal grand jury charged Griffiths, 40, with one count of conspiracy to commit criminal copyright infringement and one count of criminal copyright infringement. If convicted on both counts, the defendant could receive a maximum sentence of ten years in federal prison and a \$500,000 fine.

The indictment charges Griffiths, known by his screen nickname as "Bandido," with being co-leader of Drink Or Die, an illegal internet software piracy group founded in Russia in 1993. The Internet software piracy (or warez) group expanded internationally throughout the 1990's.

During the three years prior to its dismantlement by federal law enforcement in December 2001, the group is estimated to have caused the illegal reproduction and distribution of more than \$50 million worth of pirated software, movies, games and music.

"Griffiths thought he was beyond the reach of U.S. law enforcement," said U.S. Attorney Paul McNulty. "He will be proved wrong. We will seek formal extradition from Australia in the coming weeks, but for now, the message should be clear: no matter who you are or where you live, if you steal the intellectual property rights of individuals and businesses, we will not stop at our borders to find you and bring you to justice."

"The internet makes this type of law enforcement cooperation across international borders essential," said Michael Chertoff, Assistant Attorney General for the Criminal Division. "The indictment of Hew Raymond Griffiths shows that international cooperation can result in effective criminal enforcement on a global scale."

"While combating terrorism is our top priority, agents with the Bureau of Immigration and Customs Enforcement will continue to vigorously pursue those who use the Internet to commit crimes," said Michael Garcia, Assistant Secretary for Immigration and Customs Enforcement at the U.S. Department of Homeland Security. "Operation Buccaneer clearly demonstrates federal law enforcement's resolve to stop cyber pirates and prosecute them to the fullest extent of the law."

According to the indictment, Griffiths oversaw all the illegal operations of Drink Or Die, a warez group that specialized in "cracking" (i.e., removing or circumventing embedded copyright protections) software and then distributing the "cracked" versions to the warez scene. Members stockpiled illegal software at huge Internet computer storage sites commonly referred to as "FTP sites." They were filled with tens of thousands of individual software, game, movie and music titles worth millions of dollars. The group used encryption and an array of other sophisticated technological security measures to hide their activities from law enforcement.

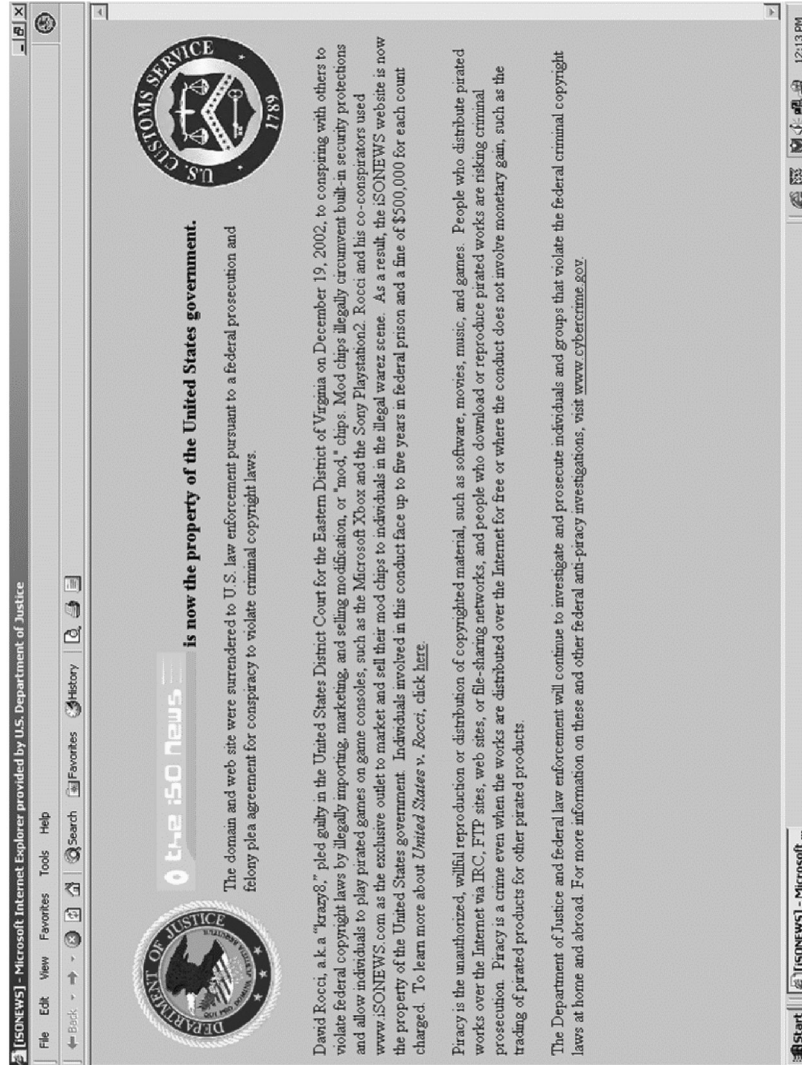
In December 1999, the defendant granted an interview to an online news source proclaiming he ran Drink or Die's day-to-day operations and controlled access to more than 20 warez FTP sites worldwide. He gave this warning to others engaged in Internet software piracy:

"I hope more people start to realize that we play a dangerous game. . . when you play with fire, you can indeed get burnt. . . . and prison is not a nice thing guys."

Griffiths' indictment is the latest action arising from the joint U.S. Customs/Department of Justice investigation known as "Operation Buccaneer", the largest international online copyright piracy investigation ever conducted by federal law enforcement. To date, 20 defendants have been convicted in the U.S. on charges of felony copyright infringement, 16 of those in the Eastern District of Virginia. Ten defendants were sentenced to terms of imprisonment of between 33 and 46 months, the longest sentences ever imposed for online software piracy. Six additional defendants are currently awaiting trial in the United Kingdom. Spin-off investigations and prosecutions are ongoing in the U.S., Finland, Norway and Sweden. Federal officials credited the assistance of the Australian Federal Police in identifying Griffiths and executing searches at his residence in Australia.

Prosecuting the case for the United States are Assistant United States Attorney Robert Wiechering; Michael DuBose, Senior Counsel, Computer Crime & Intellectual Property Section (CCIPS), and Michael O'Leary, Deputy Chief, CCIPS.

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Mr. SMITH. Okay. Thank you, Mr. Malcolm.  
Mr. LaMagna.

**STATEMENT OF RICH LAMAGNA, SENIOR MANAGER—  
WORLDWIDE INVESTIGATIONS, MICROSOFT**

Mr. LAMAGNA. Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to testify on this important topic. Let me assure you it will not be in Cantonese or Mandarin. [Laughter.]

Mr. LAMAGNA. My testimony will focus on software counterfeiting, the manufacture and sale of pirated CD-ROMs and physical components. This sophisticated form of piracy is dominated by organized criminal enterprises that produce billions of dollars in counterfeit software.

For most of its history, the software industry has battled against piracy. Despite these efforts, software piracy remains a serious problem throughout the world, accounting for one quarter of the software used in the United States and 40 percent of the software used worldwide. In some regions, piracy rates approach 90 percent.

Our industry loses almost \$11 billion each year from software counterfeiting and other forms of piracy. Annual seizures of counterfeit Microsoft products exceed \$1.7 billion. Over the next 5 years, software piracy will cost the U.S. economy more than 175,000 jobs and \$1.6 billion in tax revenues.

Software counterfeiters go to great lengths to make pirated software look genuine in an effort to deceive the consumer and maximize illicit profits. Here is an example of counterfeit Office '97. Even the most sophisticated consumer would have great difficulty in distinguishing it from the genuine product.

Software counterfeiters use state-of-the-art technology to manufacture counterfeit CD-ROMs, components, and packaging. For many years, Microsoft has worked to outpace counterfeiters by developing physical security features that help consumers and law enforcement agencies distinguish legitimate software from sophisticated counterfeits.

For example, Microsoft's certificate of authenticity incorporates several proprietary technologies, including special inks and micro text. Because these physical security features are increasingly difficult to reproduce, counterfeiters are now combining pirated CD-ROMs and packaging with genuine security features obtained through theft or fraud.

More than 500,000 genuine certificates have been stolen in the U.S. and Europe recently. The stolen certificates are sold to counterfeiters through a variety of distribution channels.

Currently, Federal law does not prohibit trafficking in genuine physical security features. This loophole discourages law enforcement from investigating and prosecuting persons who facilitate counterfeiting by trafficking in genuine physical security features.

Mr. Chairman, we look forward to working with you and the Subcommittee to address this matter. Having spent much of my career fighting drug traffickers, I am struck by the similarities between the illegal drug trade and counterfeiting, which is equally profitable but involves much less risk.

Like drug trafficking, software counterfeiting operations consist of global networks of well-financed and sophisticated criminal enterprises. In the United States, Microsoft and other intellectual property owners have worked closely with Congress and Federal authorities to ensure that counterfeiting laws, enforcement, and penalties keep pace with counterfeiting crimes.

In addition, Microsoft's investigative team has worked closely with Federal and local law enforcement to bring about several important counterfeiting seizures, particularly in California, a major distribution center for counterfeit software.

In late 2001, the U.S. Customs Service, aided by a State and local task force and Microsoft investigators, seized \$100 million in counterfeit software, Microsoft and other products—the largest seizure in software history.

Working closely with Taiwan authorities, Customs uncovered a major international counterfeiting network, financed by criminal enterprises in Asia. This raid demonstrates the critical importance of close multilateral cooperation between industry and law enforcement.

Unfortunately, few foreign law enforcement agencies share a strong commitment to anti-counterfeiting enforcement. As a result, the foreign criminals that finance and control worldwide counterfeiting operations are rarely prosecuted or punished.

All governments must recognize that software counterfeiting is a serious crime that demands the same level of commitment and cooperation that we bring to other global organized crime activities. We encourage the Federal Government to send a clear message to foreign authorities that software counterfeiting is a major crime priority that demands tough penalties, a sustained commitment of resources, and multilateral cooperation among government agencies and industry.

Thank you.

[The prepared statement of Mr. LaMagna follows:]

#### PREPARED STATEMENT OF RICHARD C. LAMAGNA

Mr. Chairman, members of the Subcommittee, thank you for the opportunity to testify on this important topic. My name is Rich LaMagna, and I am Senior Manager of Worldwide Anti-Piracy Investigations at Microsoft Corporation. I joined Microsoft in 1999 after a 28-year career as a Special Agent with the DEA and the FBI investigating international drug trafficking organizations. My testimony this morning will focus on software counterfeiting—the illegal manufacture and sale of pirate CD-ROMs, packaging, and other physical components. This particularly sophisticated form of piracy is increasingly dominated by international organized crime groups that produce billions of dollars in counterfeit software each year.

#### I. THE SCOPE AND IMPACT OF SOFTWARE COUNTERFEITING

##### *A. Economic Contribution of the Commercial Software Industry*

Over the past 25 years, computer software has fundamentally reshaped every facet of our lives and helped secure this country's economic leadership. By the late 1990s, the software industry employed more than 800,000 U.S. workers with aggregate wages of \$55.6 billion. By the year 2008, the software industry is expected to employ more than 1.3 million workers in the United States alone.

Annually, the software industry contributes more than \$28 billion in tax revenues to federal and state governments, benefiting a host of national and community programs. This tax contribution is expected to reach \$50 billion by the year 2008. Also significant is the industry's contribution to the U.S. balance of payments. While the U.S. trade deficit reached new record highs in 2000, the U.S. software industry gen-

erated a trade *surplus* of more than \$20 billion. The software industry's growing trade surplus means more jobs and tax revenues for the U.S. economy.

The success of the U.S. software industry is due in large part to this country's historical commitment to strong intellectual property protection. It is no coincidence that the United States—the world's leading advocate for intellectual property rights—is also home to the world's largest software industry. The software industry's continued growth and economic contributions are directly dependent on our ability as an industry and a nation to eliminate software theft.

#### *B. Economic Impact of Software Piracy and Counterfeiting*

For almost fifteen years, the software industry has battled against software theft, recognizing that widespread piracy threatens the very existence of our industry. Despite these efforts, software piracy remains a serious problem throughout the world, accounting for one-quarter of the software used in the United States, and 40 percent of the software used worldwide. In parts of Asia and the former Soviet Republic, piracy rates approach 90 percent, virtually eliminating sales of legitimate software.

The software industry loses almost \$11 billion each year from counterfeiting and other forms of software piracy. Annual seizures of counterfeit Microsoft products exceed \$1.7 billion. These revenue losses directly translate into lost jobs and opportunities for the U.S. economy. By the late 1990's, software piracy had cost the U.S. economy more than 109,000 jobs and almost 1 billion in tax revenues; by 2008, piracy-related losses will nearly double, accounting for 175,000 lost jobs and \$1.6 billion in lost tax revenues.

### II. TRENDS IN SOFTWARE COUNTERFEITING OPERATIONS

Unlike the cheap fakes sold on street corners, counterfeit software is typically marketed as genuine product to unsuspecting consumers who would never knowingly purchase illegal products. To create the look of genuine packaged software, counterfeiters use state-of-the-art technology to create near-perfect copies of Microsoft CD-ROMs, packaging, documentation and other components. Because counterfeiters bear none of the R&D, marketing or support costs that determine the price of legitimate software, these criminal operations are able to reap enormous profits from the sale of counterfeits.

#### *A. Trafficking in Physical Anti-counterfeiting Features*

For many years, Microsoft has worked to outpace counterfeiting technology by developing physical product features that help consumers and law enforcement agencies distinguish legitimate software from sophisticated counterfeits, much in the same way the US Government authenticates its paper currency. For example, Microsoft packaging has for many years included a certificate of authenticity ("COA") that incorporates special inks, holograms and micro-text. Microsoft has invested several millions of dollars to develop an edge-to-edge hologram that covers the entire surface of the CD-ROM. (Examples of these features are included in Attachment to this testimony.) The edge-to-edge hologram involves a highly sophisticated, proprietary technology that is etched into recent versions of Microsoft Office.

Because these physical anti-counterfeiting features are increasingly difficult to reproduce, counterfeiters are now combining pirate CD-ROMs and packaging with genuine components obtained through theft or fraud. In recent years, more than 100 robberies of authorized replicators in the US and Europe have netted 540,000 Microsoft COAs with an estimated value of \$50 million. According to our sources, genuine COAs, end user manuals, end user license agreements and other physical components are in high demand among counterfeiters because they significantly increase the marketability and selling price of counterfeit software.

So far, counterfeiters have found it impossible to replicate the edge-to-edge technology. As an alternative, they have developed holographic stickers that, when attached to the CD-ROM, closely resemble the look of the edge-to-edge hologram. Recent versions of these fake stickers found in Asia are of such high quality, few consumers would be able to detect the counterfeit.

#### *B. Proposed Clarification to Federal Anti-counterfeiting Law*

Currently, federal law prohibits trafficking in counterfeit software and "counterfeit labels," but does not provide adequate civil and criminal remedies to combat the sale of genuine physical components or the combination of stolen components with counterfeit CD-ROMs and packaging. Moreover, it is unclear whether prohibitions against counterfeit labels would cover counterfeit edge-to-edge holograms or COAs. This loophole in existing federal law makes it very difficult for prosecutors to target those criminals who clearly facilitate counterfeit sales by trafficking in genuine or counterfeit physical anti-counterfeiting features.

Mr. Chairman, we thank you for your leadership last year in introducing a clarification to federal anti-counterfeiting law that would close this loophole. We look forward to the opportunity to work with you and the Subcommittee to address this matter.

### III. INVOLVEMENT OF ORGANIZED CRIME

The production and distribution of high quality counterfeit software require a high level of planning, funding and organization; and access to replicating equipment, raw materials, packaging, shipping facilities, and money laundering avenues. Because of the enormous opportunities for profits and the low risk of prosecution or significant punishment, software counterfeiting has become part of an intricate web of international organized crime. Although crime groups based in Asia produce the largest quantity of sophisticated counterfeits, manufacturing and distribution centers exist throughout the world. In fact, California is a major entry and assembly point for counterfeit software CD-ROMs and components.

The federal government explicitly acknowledged the growing involvement of organized crime when it created a new "Intellectual Property Rights Initiative" in 1999 to strengthen enforcement against intellectual property crime. At a congressional hearing, former Customs Commissioner Ray Kelly stated that—

*Our investigations have shown that organized criminal groups are heavily involved in trademark counterfeiting and copyright piracy. They often use the proceeds obtained from these illicit activities to finance other, more violent crimes. These groups have operated with relative impunity. They have little fear of being caught—for good reason. If apprehended, they face minimal punishment. We must make them pay a heavier price.*

Global counterfeiting flourishes because counterfeiters face little risk of prosecution or meaningful punishment. In the United States, Microsoft and other intellectual property owners have worked closely with Congress and Federal authorities to ensure that counterfeiting laws, enforcement, and penalties keep pace with counterfeiting crimes. In recent years, these efforts have led to important reforms, including improved sentencing guidelines for intellectual property crime, increased appropriations for IP-related law enforcement activities, and the creation of the FBI Cyber Division.

In addition, Microsoft invests millions of dollars each year to assist law enforcement in investigating criminal counterfeiting operations. Microsoft's worldwide anti-piracy team consists of more than 100 attorneys, forensic experts, and in-house and outside investigators, who work closely with law enforcement agencies in this country and throughout the world to investigate and prosecute international networks of criminal counterfeiters. In the United States, Microsoft's investigative team has worked closely with Federal and local law enforcement to bring about important counterfeiting seizures, a number of which involved organized crime:

- In February 2000, the FBI and LA Sheriff's Office led 12 raids against suspected criminal counterfeiters, resulting in the arrest of 12 individuals. Law enforcement officials seized several thousand counterfeit copies of Microsoft software, worth more than \$5 million. The persons arrested were part of a well-organized international counterfeiting operation, with ties to organized crime groups based in Asia.
- In November 2001, the LA Sheriff's office, aided by U.S. Customs, the Secret Service and Microsoft investigators, executed the most significant raid and seizure of Microsoft software and components in U.S. history, with an estimated retail value of \$100 million. The raid interrupted a major counterfeit software distribution pipeline that moved containers of counterfeit software and other illegal components from Taiwan through the Port of Los Angeles. Taiwan authorities later confirmed that the counterfeiting operation was financed by criminal groups based in Asia.
- In April 2002, the FBI and several other federal and local law enforcement agencies dismantled a highly organized international counterfeiting ring, with assembly and distribution arms in Northern California, Washington and Oregon and direct ties to Asia-based criminal groups. The undercover investigation, known as "Operation Cyberstorm," led to the arrest of 27 individuals and the seizure of approximately \$10 million in counterfeit software and components. The counterfeiters were also involved in money laundering and credit card fraud.

These cases demonstrate the critical importance of close, multilateral cooperation between industry and law enforcement. For example, in the 2001 raid described



above, Taiwan authorities worked closely with US law enforcement and Microsoft to investigate and prosecute the leaders of the operation based in Asia. Unfortunately, few foreign law enforcement agencies share this commitment to anti-counterfeiting enforcement; and, as a result, the foreign criminals that finance and control worldwide counterfeiting operations are rarely prosecuted or punished.

In closing, we face a daunting challenge. How can we successfully fight a well-financed, global network of counterfeiting rings, when the criminals who control these operations bear little risk of prosecution and meaningful punishment outside the United States? Clearly, we cannot succeed, until all governments recognize that software counterfeiting is a serious crime that demands the same level of enforcement and cooperation that we bring to other global organized crime activities. We encourage Federal law enforcement agencies to join together in sending a clear, unified, and unequivocal message to foreign authorities that software counterfeiting is a major crime priority that demands tough penalties, a sustained commitment of law enforcement resources, and multilateral cooperation among national authorities and industry.

Thank you.

## Attachment

### **Examples of Microsoft Anti-counterfeiting Features**



Certificate of Authenticity



CD-ROM Edge-to-Edge Hologram

Mr. SMITH. Thank you, Mr. LaMagna.  
Mr. Valenti.

**STATEMENT OF JACK VALENTI, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MOTION PICTURE ASSOCIATION OF AMERICA (MPAA)**

Mr. VALENTI. Thank you, Mr. Chairman, Mr. Berman, and Members of the Committee.

Before I begin, I want to introduce a gifted young independent filmmaker from Britain, whose blockbuster film, "Bend It Like Beckham," is proving very popular in Europe. But, alas, it's been hijacked all over the world, and here it is avalanching this country. And guess what? Her film doesn't come out yet in the United States for another week.

Ms. Gurinder Chadha. Stand up. I want them to see you.

Because in the words of Peter Finch in the movie "Network," she's mad as hell, and she's not going to take it anymore. [Laughter.]

Mr. SMITH. Thank you for being here.

Mr. VALENTI. Let me do my little show and tell. Hope you can see the screen over there. Beginning in 1998, Mr. Chairman, we had zero seizures of counterfeit DVDs in this country. And now, you can see in the year 2002 over 7 million.

Now here is a major trading and piracy. A major motion picture was released in the United States November the 22nd last year. Two days before, in a press screening, it was camcordered and then ran like a wire through all of Asia and Malaysia, Indonesia, Thailand, Beijing, Hong Kong, and so forth. And by the time this picture opened, it had been stolen all over the world.

The major centers of DVD counterfeit production are Malaysia, Thailand, Taiwan, China, Philippines, and now Russia. Now here's a map of Russia. There are about 26 pirate factories in Russia, and guess what? Six of them are on land owned by the Russian government.

They're now beginning—it moved over and avalanched Central and Eastern Europe and now are invading the European Union, which is the largest international market for our movie.

This next slide shows you how ingenious these dudes are all over the world. These are criminal elements. A raid of a DVD factory revealed an underground tunnel, where a meter-wide little electric car transported the counterfeit DVDs from their factories into a house several hundred yards away.

Our surveillance team thought it was mighty strange that no material was being shipped out of the factory until we did a raid. The enforcement team broke through the roof and then rappelled down in the place before they could destroy the evidence and found this underground tunnel.

As you can see in this next slide how ingenious they are and how much money they spend to do this because it's much more profitable being in the pirating business today than in the drug trade. Much less risk, as Mr. Malcolm and this Microsoft executive pointed out. You can make a lot more money with a lot less risk than being in drugs.

Next slide is a—this is very ingenious. This is a submersible barge. It's a submarine barge. It has no propulsion. Fishing boats—when it gets underwater, fishing boats tow it. And if somebody wants to raid the fishing boat, they immediately cut the line to the submersible barge and then locate it by GPS positioning. So they can go back later and pick it up.

This next slide shows you what's in that damned barge—174,000 counterfeit DVDs were found when we made this raid. They have very ingenious methods of smuggling. Shipping containers, cars with hidden compartments, stacks of DVDs in bags of asphalt, concealed cavities in stacks of cardboard. You name it, they do it.

Now this looks like an innocent—next slide is an innocent, pristine, pure little blank DVD. But guess what, you pull back the cover, and underneath, you have a pirated DVD. The DVDs go from—they're using DHL and FedEx. And by the way, both of those express services have been cooperating fully with us.

We found in one raid that we found 418 parcels, and you can believe this, and we had 10,000 pirated DVDs in there. Now these DVDs will go all over the world, but mainly to Australia, the Middle East, Europe, and the United States. And that's pretty much all over the world.

And finally, piracy and guns go hand in hand. This is an organized crime enterprise, Mr. Chairman. This is a sniper rifle, M-16, heavy weapons, as well as cocaine was there. Wherever we go, we find this connection.

The Customs Service, in their bulletin of November 2, 2002, said there was a definite connection between organized crime and terrorists. This is where the connection is. A lot of terrorists are being funded by this illegal merchandise.

I think Attorney General Malcolm has been absolutely wonderful and sturdy in making sure that in this country we are really on top of these and making it clear that this is going to be a high-risk, low-reward business. But, alas, that's not so abroad.

I hope these remarks charm you greatly, but I think I'll stop at this point. Thank you, sir.

[The prepared statement of Mr. Valenti follows:]

#### PREPARED STATEMENT OF JACK VALENTI

America's crown jewels—its intellectual property—are being looted. Organized, violent, international criminal groups are getting rich from the high gain/low risk business of stealing America's copyrighted works. We don't know to what end the profits from these criminal enterprises are put. US industry alone will never have the tools to penetrate these groups or to trace the nefarious paths to which those profits are put. For these reasons it is entirely suitable and necessary that the Subcommittee on Courts, the Internet and Intellectual Property of the House of Representatives Committee on the Judiciary hold this hearing and illuminate the nature of the problems and the effect on the copyright industries (consisting of movies, TV programs, home videos, books, music, computer games and software).

#### THE ECONOMIC WORTH OF THE COPYRIGHT INDUSTRIES

The copyright industries were responsible in 2001 for some five percent of the GDP of the nation. Over the past quarter century, these industries' share of GDP grew more than twice as fast as the remainder of the economy. They earn more international revenues than automobiles and auto parts, more than aircraft, more than agriculture. The copyright industries are creating *new* jobs at three times the rate of the rest of the economy. The movie industry alone has a *surplus* balance of trade with every single country in the world. No other American industry can make

that statement. And all this comes at a time when the U.S. is suffering from some \$400 billion in trade deficits.

#### DIGITAL PIRACY: THE DELIVERY DREAM, THE PIRACY NIGHTMARE

It would be a serious mistake to take our past successes for granted. While piracy has been a sad fact illuminating our lives since the blossoming of the home video entertainment business a quarter century ago, the forms of digital piracy we now face raise serious, new challenges that we need your help in addressing.

I must admit, with all appropriate modesty, that we had become fairly good at combating the old forms of analog video tape piracy. With the help of our government and international trade agreements, such as the World Trade Organization's Agreement on Trade Related Intellectual Property, most countries have adopted modern copyright laws. We had been seeing declining loss rates in many of the traditional centers of piracy. Despite our successes, we were losing close to \$3 billion dollars a year.

And then the world changed. Digital technologies, which offer so much in terms of enhanced clarity of image and sound, and exciting new ways to deliver high quality entertainment directly to people's homes, also gave birth to serious new forms of piracy.

By now, I presume that all of you have heard of our concerns about Internet piracy—and I assure you, that dialogue will continue. The mysterious magic of being able, with a simple click of a mouse, to send a full-length movie hurtling with the speed of light to any part of the planet, is a marketing dream and an anti-piracy nightmare. Ask the music industry how Internet piracy can devastate an industry's bottom line. As computer modem speeds accelerate and broadband access spreads across the United States and around the world, more people are gaining the ability to download full length motion pictures quickly. The threat to the motion picture industry from Internet piracy is growing.

Internet piracy is not the only digital threat we face. Today, I'd like to focus on another form of digital piracy—widespread piracy of optical discs—CDs, Video CDs, DVDs, and recordable versions like CD-Rs and DVD-Rs. The piracy of DVDs and other optical media products is dominated by organized crime and increasingly threatens our international markets, which account for 40 percent of revenues earned by the filmed entertainment industry. Indeed, all industries that rely on intellectual property protection, including the music and video game industries, are facing huge losses from optical disc piracy, especially in international markets. Microsoft products are another favorite target for the pirates.

The motion picture industry seized over 7 million pirate DVDs worldwide last year. DVD piracy didn't exist for our industry as recently as 1999.

#### "DIE ANOTHER DAY:" AN EXAMPLE OF PIRATES IN ACTION

The damage from pirated DVDs is enormous. DVD piracy erodes our home video revenues, but also corrodes revenues from our international theatrical business. Pirate DVDs often enter the market months before the release of legitimate DVDs—often before a movie is released into the theaters. Let me give you just one example. MGM's latest James Bond film, *Die Another Day*, was released theatrically in major cinemas in the United States on November 22. The first pirate copy, camcorderd from a press screening in the United States, showed up in pirated DVD format in Malaysia on November 21. By the 28th, only six days after its US theatrical release, every major market in Asia was already infected with pirate copies of *Die Another Day*. In Taiwan, theatrical release wasn't scheduled until February 1 to coincide with Chinese New Years holidays—normally a big period for cinema sales in that part of the world. The pirates had nine full weeks to sell our products in pirated form before the film was legitimately released in theaters.

#### A SNAPSHOT OF OPTICAL DISC PIRACY AROUND THE WORLD

The problem of large-scale pirate optical disc production began in China in the mid-90s. When China cut off the export of piratical discs in the late 1990s, the pirates packed up their equipment and relocated to more hospitable areas where enforcement was lax or absent. Now we are seeing major problems with DVD production in Malaysia, Thailand, Taiwan, Philippines, and Indonesia. Pakistan, Bangladesh, Ukraine, and elsewhere in Central Europe are host to factories replicating pirate copies of music CDs. The music industry's problems today are always a danger sign for us, since pirates often start with music and then move on to movies, video games and other products.

In the past year, we have also witnessed a major surge of large-scale factory production of DVDs in Russia. Today there are at least 26 optical plants in Russia, in-

cluding at least five that specialize in the production of DVDs. The number and overall capacity of these plants has more than doubled in the past two years. Nine of these plants are located on property owned by the Russian Government.

Pirate DVDs have devastated the local market in Russia. Pirate DVDs have so saturated the Russian market that the pirates have resorted to selling them on the streets *by the kilo*. Pirate DVDs are sold everywhere—at street markets, in kiosks, in retail stores and over the Internet.

Those 26 plants in Russia currently have capacity to replicate about 300 million DVDs and CDs a year; legitimate demand in Russia is approximately 18 million units. This excess capacity points to the fact that the Russian pirates are targeting export markets—OUR export markets. Piracy in Russia poses a major threat to revenues across Europe. In 2002 MPA's anti-piracy operations seized pirate Russian DVDs in markets across Central and Eastern Europe. In July a raid at a retail market in Poland turned up over 4000 copies of pirate discs from Russia. Those discs contained 15 different language tracks—from Finnish and Swedish to Greek and Turkish, Dutch, Danish, to Indian and Arabic. If bold actions aren't taken quickly to shut down this piracy, American sales of copyrighted works to Western Europe—our most lucrative market in the world—will be demolished by these pirated imports from Russia. The time to act is now before these criminals further build out their distribution networks and alliances throughout Central and Western Europe.

Even before large-scale factory production has been brought under control, we are now seeing the rapid growth of local burning of movies and other forms of copyrighted content onto blank recordable media—CD-Rs and DVD-Rs. This kind of piracy is more dispersed geographically, since the piracy takes place in medium to small "labs" with banks of CD burners, but is often still highly organized. The retail markets in Taiwan are filled with this kind of pirate product; not coincidentally, Taiwan is one of the world's largest producers and exporters of blank optical discs, fueling this problem around the world.

#### THE ORGANIZED CRIME CONNECTION

Several U.S. government agencies are bringing attention to the link between organized crime and copyright piracy. The Federal Bureau of Investigation's website home page states the following:

*"Unlike criminals who engage in other types of criminal activity, those who commit IP crimes can not easily be categorized. Counterfeiters, software pirates, and trade secret thieves are as different as the intellectual property they counterfeit, steal, and sell. In general, software pirates have an acute interest in computers and by extension, the Internet. Many counterfeiters hail from foreign countries, such as South Korea, Vietnam, or Russia. They are frequently organized in a loosely knit network of importers and distributors who use connections in China, Southeast Asia, or Latin America to have their counterfeit and imitation products made inexpensively by grossly underpaid laborers. There is also strong evidence that organized criminal groups have moved into IP crime and that they are using the profits generated from these crimes to facilitate other illegal activities. There are a number of reasons for the dramatic increase in IP crime in recent years. First, many forms of IP can be produced with minimal start-up costs making IP crimes accessible to large numbers of people; second international enforcement of IP laws is virtually nonexistent; and finally, domestic enforcement of IP laws has been inadequate and consequently the level of deterrence has been inadequate."*

The link between piracy and organized crime has been widely accepted by the European Commission, which recently organized a forum to address the prevention of organized crime and included a discussion of piracy and counterfeiting. Interpol has also acknowledged the link with organized crime and established the Interpol Intellectual Property Crime Action Group. Many national enforcement authorities, from the United Kingdom to Australia have recognized that piracy and organized crime go hand in hand.

The Secretary of State for Northern Ireland, the Rt. Hon. Dr. John REID, last year announced the Serious & Organised Crime Threat Assessment & Strategy. He identified as immediate priority areas of criminality: (1) Armed Robbery; (2) Counterfeit Goods—Intellectual Property Crime; (3) Tobacco and fuel smuggling; and (4) Drug Dealing.

#### CASE EXAMPLES OF ORGANIZED CRIME

Pirate factories go to great lengths to conceal and harden their operations. One raid in October 2001, near Bangkok, revealed an underground tunnel linking a fac-

tory to a residential house. Pirate products were moved out of the factory on a meter-wide, specially installed electric rail system that ended under the kitchen sink of a near-by home. The products were trucked away from the back of the house, effectively hiding the movement of pirated goods out of the factory.

The pirates employ sophisticated security systems, such as hardened front doors and surveillance cameras, to delay entry by enforcement officials into the factories. These security devices give the pirates the 10–15 minutes they need to destroy the evidence of their crimes in vats of acid kept specifically for this purpose. Local police have been forced to adopt equally sophisticated responses. In the raid on a factory in Thailand the police, accompanied by our anti-piracy enforcement team, broke through the roof of the factory and rappelled down ropes in order to maintain the element of surprise.

#### SOPHISTICATED SMUGGLING

The pirates also use highly sophisticated smuggling methods. Macau Marine Police, working with Hong Kong Customs, intercepted two submerged, un-powered, purpose-built “submarines” in two, separate raids in April and May 1999. These submarines were towed behind fishing boats and had ballast and compressed air tanks that enabled the sub to be raised and lowered. If enforcement officials intercepted the fishing vessel, the tow line could be cut, the barge’s location marked with GPS positioning, and later recovered when the coast was clear. In these cases, however, the authorities, relying on sophisticated intelligence, knew what they were looking for and were able to recover 174,000 pirate optical discs in one seizure and 73,000 in the second. These cases demonstrate the scale and level of sophistication that criminal syndicates employ to evade detection. Traditionally, such methods have been reserved for the smuggling of drugs and other contraband, including firearms.

Pirates use other ingenious methods to smuggle their products. The International Federation of the Phonographic Industries, in a raid with Polish Customs last year, intercepted a car suspected of transporting pirate CDs from Russia. When the authorities removed the car’s fender, they found a hidden compartment full of pirated CDs. MPA has found hidden compartments in shipping containers, stacks of DVDs concealed in bags of asphalt, and ingenious concealed cavities in what appeared to be stacks of flattened cardboard boxes.

Sometimes the pirates try to ship pirated products by disguising them as legal products. A law enforcement official in Australia thought he had a shipment of blank DVDs—until he peeled back the label on one of the copies—and uncovered a shipment of pirated copies of the film “Ali.”

With the cooperation of major express mail delivery services, we have made progress in cutting down the shipment of pirated DVDs from Malaysia. In a major raid last July in Penang, Malaysia, we discovered 418 separate parcels containing about 10,000 pirate DVDs destined for Australia, the Middle East, Europe and even the United States.

#### VIOLENCE AND INTIMIDATION

Pirates also employ violence and intimidation. A raid on a street market in Malaysia last summer turned into a riot. A vehicle driven by the pirates rammed the van transporting the Malaysian enforcement officials and MPA’s anti-piracy investigators to the raid. Bat wielding pirates attacked the enforcement team. Only after the Malaysian enforcement officials fired their weapons into the air did the crowd disperse.

Pirates have directly threatened Government leaders. Last year, the President of the Municipal Council in a city in Malaysia received a personal death threat along with a threat that his daughter would be raped if the crackdown on illegal VCD traders continued. The Minister of Domestic Trade and Consumer Affairs in Malaysia also received a personal death threat.

In the Netherlands two years ago, our local program helped smash a sophisticated and violent criminal organization that was distributing compilation pirate optical discs under the HiteXplosion and MovieBox labels. The discs contained monthly compilations of interactive games, movies and music. Two of the pirates had organized the torture of two associates for under-reporting their sales of pirated CDs and DVDs. The two were subsequently sentenced to four and a half year prison terms on charges of extortion and accessory to kidnapping and attempted assault.

In the UK, there is increasing evidence that Chinese crime gangs control much of the pirate DVD business in London and the South East. Illegal immigrants have, it appears, been pressed into selling pirate DVDs by Chinese human traffickers (known as Snakeheads) to pay off family debts to the gangs.

## GOVERNMENTS NOTE LINKS TO TERRORISM

Mr. Chairman, let me commend to your attention an article by Kathleen Millar in the November 2002 issue of *U.S. Customs Today* entitled "Financing Terror: Profits from Counterfeit Goods Pay for Attacks." With your permission, I would like to enter this article into the record. The article outlines the "close connections between transnational crime and terrorism." It states that the participants at the 1st International Conference on IPR hosted by Interpol in Lyon, France in 2001 "all agreed the evidence was indisputable: a lucrative trafficking in counterfeit and pirate products—music, movies, seed patents, software, tee-shirts, Nikes, knock-off CDs and 'fake drugs' accounts for much of the money the international terrorist network depends on to feed its operations." The article concludes that "The new link between commercial-scale piracy and counterfeiting has redirected public attention in 2002, and law enforcement agencies like Customs and Interpol are going after the organized crime syndicates in charge of what was too often viewed as a 'victimless crime.' September 11 changed the way Americans look at the world. It also changed the way American law enforcement looks at Intellectual Property crimes."

The Police Service of Northern Ireland's (PSNI) Anti-Counterfeiting and Racketeering Unit also reports that paramilitary organizations in Northern Ireland regard counterfeiting as their preferred fund-raising option. According to the PSNI, these paramilitary groups last year made specific threats against officers involved in anti-piracy raids at Newtownards Market after PSNI officers had seized over £50,000 worth of counterfeit goods, including DVDs.

## AN APPEAL FOR ASSISTANCE

To deal with this kind of organized crime, MPAA and our fellow copyright associations, need the help of governments—both here and abroad. It is simply not possible for a private sector organization to penetrate this kind of organized, criminal endeavor without the help of governments. Governments need to dedicate the same kinds of legal tools to fighting piracy that they bring to other kinds of organized crime: money laundering statutes, surveillance techniques, and organized crime laws.

We also need your help to let foreign government officials whom you meet here or when you are abroad, know that inaction is not an option in the fight against piracy. The continued vitality of the copyright industries, one of America's signature industries, is at stake.

We need our enforcement agencies to help train and work with foreign enforcement agencies to stem the flow of piracy across borders.

We also need the continued assistance of all the agencies that make up the "country team" at American embassies abroad. Ambassadors and their staff from State and Commerce have done outstanding jobs in offices from Moscow to Taipei in helping press for better laws and better enforcement. They help deliver the message that failure to address these high levels of crime has consequences for our bilateral relationships. The traditional enforcement agencies—Customs and legal attaches—are also playing an important role in some countries in engaging their counterparts in dialogue, in improving coordination among enforcement agencies around the world, and in training foreign law enforcement in all aspects of fighting organized crime—including copyright theft.

Recently negotiated trade agreements are playing a crucial role in raising the standards of copyright law and enforcement around the world. The Office of the US Trade Representative has done an excellent job in the newly negotiated FTAs with Chile and Singapore incorporating provisions that raise the standards for copyright protection to the level of US laws and help provide the tools we need to combat this menace. The agreements also help open markets—and the more open the market, the less the incentive for piracy. I hope I can encourage you to support these Free Trade Agreements when they come before Congress later this year.

## ENTERTAINMENT INDUSTRY COALITION FOR FREE TRADE

I'm pleased to announce that in recognition and support of the value of trade agreements in helping to move our international agenda forward, we will be launching at noon today an Entertainment Industry Coalition for Free Trade. This coalition brings together a wide range of entertainment industries and associations—films, music, entertainment software, theater owners, and television programmers. We hope that many of you can join us at noon today as we launch this Coalition whose main objective is to spread the word that trade matters to our industries.



## IN CONCLUSION

Large, violent, highly organized criminal groups are getting rich from the theft of America's copyrighted products. Only when governments around the world effectively bring to bear the full powers of the state against these criminals can we expect to make progress. Only when industry and governments join forces to fight these organized groups will we succeed in protecting one of the jewels in America's trade crown. A singular truth exists in the movie industry: "If you can't protect what you own, you don't own anything."

# U.S. CUSTOMS TODAY

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## Financing Terror

### *Profits from counterfeit goods pay for attacks*

By Kathleen Millar, *Public Affairs Specialist, Office of  
Public Affairs*

Anti-terrorist organizations in the U.S. and abroad are homing in on the close connections between transnational crime and terrorism. Before 9/11, law enforcement defined both as strategic threats but tended to approach each problem separately, constructing one set of responses to criminal activities-like money laundering, IPR violations, and drug trafficking-and devising other tactics to combat terrorism.

Today, in a post-9/11 environment, agencies like Customs and Interpol understand that the international underworld is a breeding ground for terrorism, providing groups like al Qaeda, Hamas, Hezbollah, and the Irish Republican Army (IRA) with funds generated by illegal scams, and with opportunities to launder millions in terrorist dollars. Behind the army of hijackers, suicide bombers, and terrorist gunmen stands an even greater number of "company men"-criminal entrepreneurs and financiers in suits who understand the best way to bankroll Armageddon is through the capitalist system.



Photo Credit: James Tourtellotte

### Counterfeit "designer bags" can generate profits

Fat Harold's Carolina Cruisin'  
fundraiser

30 athletes, 117 medals at  
the International Law  
Enforcement Games

Retirees: Still on the job

Personnel and payroll self-  
service available 24/7

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#### for terrorists.

They run what look like legitimate businesses, travel to "business meetings" in Frankfurt, Amsterdam, and New York, and pay fictional "employees" with money that feeds and houses terrorist cells. They run computer manufacturing plants and noodle shops, sell "designer clothes" and "bargain-basement" CDs. They invest, pay taxes, give to charity, and fly like trapeze artists between one international venture and another. The endgame, however, is not to buy a bigger house or send the kids to an Ivy League school - it's to blow up a building, to hijack a jet, to unleash a plague, and to kill thousands of innocent civilians.

#### Interpol and Customs join forces against IPR violations

Financing terrorism is a topic that Customs and Interpol are taking seriously. Last year, soon after the attacks on New York and Washington, Interpol hosted the 1st International Conference on IPR in Lyon, France. Enforcement and security experts outlined the relationships between global commerce and global crime - instances in which profits from counterfeit merchandise funded terrorist activities - and participants agreed that Interpol needed to create a Group of Experts on International Property Crime.

Interpol hosted the first meeting of the multi-agency, IP Advisory Group on July 23. The group met again on October 3, and law enforcement officials from U.S. Customs, Finnish Customs, Ireland, Northern Ireland, and the Royal Canadian Mounted Police joined forces with the corporate community to hammer out concrete responses on an international scale. The World Intellectual Property Organization, the Motion Picture Association, the International Anti-Counterfeiting Coalition, Procter and Gamble, the World Customs Organization, the Pharmaceutical Security Institute, the International Federation of Phonographic Industry, the Global Anti-Counterfeiting Group, the European Union, and REACT Services (UK) all had representatives at the table.

"Our objective," says Erik Madsen, a crime intelligence officer with Interpol, "was to raise awareness, to create a strategic plan to fight this kind of crime, and to take action."

In the end, all agreed the evidence was indisputable: a lucrative trafficking in counterfeit and pirated products -

music, movies, seed patents, software, tee-shirts, Nikes, knock-off CDs, and "fake drugs" - accounts for much of the money the international terrorist network depends on to feed its operations.

New York's Joint Terrorist Taskforce reported a counterfeit T-shirt ring had used sales profits to subsidize the bombing of the World Trade Center in 1993. In 1999, an International Chamber of Commerce official reported the IRA was financing its operations by selling pirated videos, including a copy of "the Lion King." In 2000, a naturalized Paraguayan citizen born in Lebanon was charged with selling millions in counterfeit software out of a headquarters operation in the notorious piracy haven of Ciudad del Este; allegedly, the proceeds went to the militant Islamic group Hezbollah. Last year, Microsoft officials based in London charged counterfeiters were using the Internet to sell pirated software, an effort they described as one designed to support drug running and terrorism.

#### **Losses from counterfeiting and piracy outstrip 9/11 impact on airlines**

For years, legitimate manufacturers have cited huge financial losses, the run-off from IPR violations, as a primary reason to pass tough IPR legislation and enforce anti-counterfeiting laws. What policy-makers sometimes failed to note was the sheer enormity of those losses. After 9/11, leaders in both the public and private sectors described the loss to the U.S. airline industry as "catastrophic." While the airline industry accounts for about 10 percent of the nation's gross domestic product, copyright industries generate more foreign sales and exports than the aircraft and aircraft parts industries combined.

The new link between commercial-scale piracy and counterfeiting has redirected public attention in 2002, and law enforcement agencies like Customs and Interpol are going after the organized crime syndicates in charge of what was too often viewed as a "victimless crime." September 11 changed the way Americans look at the world. It also changed the way American law enforcement looks at Intellectual Property crimes.

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Mr. SMITH. Thank you, Mr. Valenti.  
Ms. Vidov.

**STATEMENT OF JOAN BORSTEN VIDOV, PRESIDENT, FILMS BY JOVE, INC.**

Ms. VIDOV. Chairman Smith, Congressman Berman, and other distinguished Members of the Subcommittee, I want to thank you for the invitation to appear here today.

I am president of a U.S. small business which has encountered extraordinary difficulties as licensee of Russian intellectual property. I am here to describe these difficulties because our experience illuminates the links between copyright piracy in Russia and organized crime.

As my testimony will show, the organization behind Russian copyright piracy is the government itself, directed at the highest level by the Ministry of Culture. What fits the definition of organized crime more than a foreign government conspiring to steal the property of a small U.S. business? That is the worst kind of organized crime by the most powerful possible organization.

Eleven years ago, my company signed a contract with Russia's premier animation studio, Soyuzmultfilm, to restore and market a large library of over 100—or 1,000 animated films produced during the Soviet era. We invested millions of dollars to acquire, repair, restore, and distribute these works.

Together with our partner, Mikhail Baryshnikov, we made the animation accessible for the first time to a greater worldwide audience by creating dubbed version with actors such as Charlton Heston in English, Catherine Deneuve in French, and Julio Iglesias in Spanish.

Seven years after we signed our contract, when our investment was showing a profit, officials of the Russian Ministry of Culture began a campaign to retroactively void our contract. In '99, they set up in Moscow a dummy corporation with the same name as our contracting partner and claimed that their new company was the true copyright holder back in 1992.

Thus began a protracted series of suits and countersuits in the Russian courts between the animation studio that had licensed the rights to us and the Ministry of Culture. During this period, Films by Jove suffered financial losses because the ministry prohibited the Russian State Film Archive from supplying us with films for which we had the rights.

After our Russian licensor won a series of decisions and appeals against the Ministry of Culture, the ministry resorted to manipulating the courts. The chief justice of the Russian commercial court was instructed at an ex parte meeting to "protect State interests." As a result, all lower court rulings that had gone against the ministry were vacated.

Films by Jove successfully defended its copyright in the U.S. courts. In August 2001, the U.S. Federal court for the Eastern District of New York held that Films by Jove had licensed the rights to the animation library from the proper rights holder. The dummy corporation was a party to the case and agreed to be bound by the judge's ruling.

Despite this, the Ministry of Culture has been flouting the U.S. decision for more than a year. For example, ministry officials have been sending letters via Russian embassies to broadcasters with whom we are negotiating, informing them—falsely—that only licenses issued by the dummy corporation are legitimate and implying that my company does not have the right to contract out the animation.

Ministry employees have been showing up at international sales expos, announcing that we are pirates and thieves and trying to sell our own product. In Japan and Korea, our distributors have been terrorized by a Soviet expatriate acting on instructions from the ministry and insisting that all royalties be paid to him instead of to us.

Most recently, the Ministry of Culture tried to make arrangements to have the American Film Institute screen the same animated films that were the subject of the Federal court decision. Fortunately, the AFI discovered in time that the ministry did not hold rights to these works.

The Ministry of Culture's campaign against my company has not been stopped by the intervention of U.S. Government officials. You, Congressman Berman, together with Congressmen Weldon and Waxman, sent two letters to the deputy prime minister in charge of the Ministry of Culture. In November, the U.S. ambassador to Russia, Alexander Vershbow, met personally with the minister of culture about our case.

The U.S. trade representative, the Commerce Department, the staff at the U.S. embassy in Moscow have repeatedly raised this matter with the minister of economic development and trade. What is the motivation between this relentless harassment that has damaged my company's reputation, deceived our trading partners, and interfered with our international sales?

We believe that part of the answer is that the ministry aims to establish a government monopoly that will funnel money directly into the pockets of top ministry officials from two major cash streams—revenues from the sale of Soviet era films, including animation, and Russian box office receipts from American movies that bring in hundreds of millions of dollars.

The Ministry of Culture has already created the new organization that will consolidate this monopoly. It is called Roskinoprokat, or the Russian film distribution. One of its publicly stated goals is to control imports of U.S. blockbusters, and it plans to open—I've got that much more.

Mr. SMITH. Okay.

Ms. VIDOV. And it plans to open offices in Los Angeles this summer. Roskinoprokat is a monolithic throwback to a Soviet-style command economy, and it is difficult to reconcile with Russia's claims to be a modern market economy.

I'd like to close my testimony by reminding you that the attempted theft of intellectual property by the Russian government officials is not limited to film, music, and software. For example, my colleague, Gary Johnson, who is here with us today, has submitted testimony about the company he heads, Sawyer Research Product.

Like Films by Jove, his company's success caught the eye of a Russian official—in his case, a local governor—who again, on the basis of “state interests,” obtained Russian court rulings that stripped Gary's company of its physical plant, equipment, and trade secrets.

Proprietary blueprints developed by another small firm, American Capital Systems, are in danger of being exploited without compensation because the company refused to pay a bribe demanded by an official of the Russian Ministry of Finance. Congressman Weiner, who represents ACS, is submitting testimony in connection with that case.

And in closing, I want to thank the Subcommittee for giving me the opportunity to testify today. I'll be happy to answer any of your questions.

[The prepared statement of Ms. Vidov follows:]

PREPARED STATEMENT OF JOAN P. BORSTEN VIDOV

Chairman Smith, Congressman Berman and other distinguished members of the subcommittee, I want to thank you for the invitation to appear before the Subcommittee today. I come to you as president of a small business that invested in Russia and is in danger of having its investment expropriated without compensation. I also come to you as the representative of a group of small businesses who have suffered a similar fate in Russia.

As a victim of Russia's weak enforcement of intellectual property rights, I come to you with a warning that Russia's disrespect for IP rights is on the increase due to the difference between stated policy and what certain government officials unofficially condone in practice. Even as Russia moves toward membership in the WTO, systematic copyright violations and collusion between government officials and pirates both continue unabated.

Finally, I come to you as a victim of a breakdown of separation of powers between Russia's executive and judicial branches: from the highest federal courts to the smallest regional courts, judges make ill-founded rulings when government officials often with private agendas exert pressure on courts in the name of “protection of state interests.”

So as you can see, I have a number of issues to discuss, but here at the outset let me make clear that my comments do not purport to make any linkage between piracy and organized crime and terrorism. Others more qualified may speak directly to those precise issues, but the purpose of my testimony today is to outline my experience with intellectual property rights violations in Russia. To demonstrate why this matters to the U.S. Congress, I would like to highlight the following points and the impact they have on our bilateral commercial relationship:

- I. IPR violations in Russia hurt U.S. investors
- II. The use of “state interests” and illegal ex-parte meetings hinder legitimate judicial reform efforts in Russia
- III. Russia disregards U.S. and international arbitration court decisions
- IV. The U.S. government must play an important role in addressing Russian IPR violations in the United States

In my conclusion, I will present several recommendations to Congress on steps that can be taken to address these issues.

I. IPR VIOLATIONS IN RUSSIA HURT U.S. INVESTORS

The International Intellectual Property Alliance (IIPA) 2003 report on Russia cites losses to U.S. copyright holders of \$1 billion a year, making Russia one of the worst violators of U.S. intellectual property rights.

The majority of my testimony will be dedicated to IPR violations in the entertainment industry (e.g., films, CDs, videocassettes, DVDs, electronic games, etc.). But there is another, equally important area impacted by IPR violations—technology transfer. I would like to share an example with you. My colleague, Gary Johnson, is President of Sawyer Research Products. (Gary is in the audience today, has submitted separate testimony for the record, and is happy to answer any questions.) Sawyer is a global leader in the business and technology of single crystal piezo-

electric materials, especially quartz, which is second only to the production of silicon in the ranking of crystal materials used in electronics.

In 1994, Sawyer became a shareholder of Quartz Glass Plant in the Vladimir region of Russia. The plant's success, in large measure the result of utilizing Sawyer's world-class technology in a neglected facility in the heart of Russia, caught the eye of the local governor who waved the "protection of state interests" flag. Shortly following a court decision favorable to their ends, private parties closely linked to the local administration deployed a private security force to block Sawyer from its own plant, despite the fact that Sawyer had not exhausted the appeals process and litigation continued. Sawyer technology now is available to a nearby plant still under state ownership, as well as to the private parties continuing to occupy the object of Sawyer's investment.

The Sawyer example highlights the devastating impact IPR violations have on U.S. small businesses investing in Russia. I would like to emphasize this point, because, unlike our larger counterparts, SMEs do not have the financial or human resources necessary to devote to the extensive legal proceedings resulting from IPR violations in Russia.

#### *Films By Jove case*

Now I would like to provide my personal experience with IPR/copyright violations in Russia.

I have been an executive in the U.S. motion picture industry for over 15 years, and am currently president and co-owner of the Los Angeles-based film production and distribution company, Films By Jove. Eleven years ago, in May 1992, we signed a contract with Russia's leading animation studio to restore and market a large body of Soviet-era animated films. For your background, during the Soviet era, this type of animation had been sold for peanuts, by the kilo, or just given as a bonus to companies buying a large package of Soviet feature films.

Today the Russian animation we distribute can be seen in theaters and on television all over the world, and is available on videocassettes and DVD in thousands of retail outlets in North America, South America, Europe, and Asia. Together with our partner Mikhail Baryshnikov, we gave the old animation new cachet by re-voicing it in English with actors such as Jessica Lange, Martin Sheen and Charlton Heston. We revoiced in French with actors like Catherine Deneuve, and in Spanish with Julio Iglesias. Together with the prestigious art book publisher Harry N. Abrams, we published the only book of Russian fairy tales currently in print in the United States, handsomely illustrated with cells from the animation.

We are proud to have contributed to the safeguarding and promotion of Russia's rich artistic heritage. We accomplished this by investing millions of dollars to acquire, repair, restore, and distribute these films, making them accessible for the first time to the general public outside the former USSR. The Soviets had freely "borrowed" Western literature and music to make some of the best animated films—a bad habit that did not end after the USSR signed its first intellectual property convention in 1973. So we also had to plead and cajole representatives of these writers and musicians to license us the rights necessary to keep these films alive.

In 1999, seven years after we licensed the animation library, when the investment in restoring the animated films first showed a profit for the Russian animation studio and for my company, the Russian State Film Committee (later absorbed into the Ministry of Culture) commenced a legal and political campaign to retroactively void our contract. This effort began when the State Film Committee set up in Moscow a shell corporation with the same name as the Russian studio from which we had licensed the animation rights. Ministry of Culture officials claimed that this new company, established in 1999, was the true copyright holder back in 1992, instead of the entity with whom we had contracted. Hence, they claimed, our contract was void retroactively.

Thus began a protracted series of suits and countersuits, decisions and appeals in Russian courts between the animation studio that had licensed the rights to us and the Ministry of Culture. During this period, Films By Jove suffered financial losses because the Ministry of Culture prohibited the Russian State Film Archives from supplying us with films for which we had the rights. Such interference with our normal business operations became part of an organized campaign to deny our property rights.

Throughout this time, Ministry of Culture officials significantly damaged my company's interests by sending letters via Russian embassies to broadcasters with whom we were negotiating—informing them, falsely, that only licenses issued by the dummy corporation were legitimate and implying that Films By Jove could not therefore contract out the rights. These misleading statements have deceived our trade partners, interfered with our commercial activities, and caused us serious fi-



nancial losses due to damage to our reputation and lost sales. Furthermore, the letters from the Ministry blatantly misrepresent the fact that Films By Jove has successfully defended its copyright in the U.S. courts. The studio with which Films by Jove contracted in 1992 was also successful in the Russian court system, only to have the decisions overturned in the name of “state interests.”

The unrelenting and organized efforts by Russian government officials to annul the contractual rights of Films By Jove, and to destroy our investment, have already come to the attention of the U.S. Congress. In 2002, two letters concerning our case were sent to Russian government officials jointly signed by Congressman Berman, Congressman Waxman and Congressman Weldon, including the following points:

1. Officials of the Russian government “appear to have inappropriately influenced the decisions of the Russian courts in violation of the constitutional separation of powers between the two branches of government”;
2. Such efforts directly harm the long-term investment of Films By Jove; and
3. The Ministry of Culture does not appear to be committed to safeguarding the rights of American investors, contrary to President Putin’s repeated statements pledging that investors will be guaranteed a level playing field, adherence to the rule of law, an independent judiciary, and no government interference in private commercial contracts.

In response, Congressmen Berman, Waxman and Weldon received a letter from the Russian Ambassador to the U.S. questioning the reference to Films By Jove as an investor. Apparently the Russians destroyed evidence of our wire transfers and payments to the studio (assuming U.S. banks do not keep records) because, according to the Russian Ambassador, the Russian company received no payments from the U.S. party to the contract.

In addition to the assistance we received from the U.S. Congress regarding our case, U.S. Ambassador to Russia Alexander Vershbow and the staff at the U.S. Embassy have also raised our case repeatedly with the Minister of Economic Development and Trade. Ambassador Vershbow met personally with the Minister of Culture last November and explained that we are ready to conduct negotiations aimed at reaching an amicable and transparent solution based on the rule of law.

In spite of repeated assurances that our concerns would be addressed, a new full-scale campaign was mounted at an international television sales expo in France last fall to advise all buyers that we were “pirates” and “thieves,” that all new contracts had to be signed with them, and that any contracts previously signed with our company were null and void. The state-studio’s brochures specifically advertised the titles we legally acquired, paid for, and into which we invested significant amounts of money for restoration and revoicing in order to make them sellable to international broadcasters.

To address this situation, we had recourse to a French court decision that we had won in 1996 against Sovexportfilm, another state-owned Russian company that we caught pirating in the early 1990s (it too enjoys Ministry of Culture support). On the basis of that decision, a French magistrate ordered his bailiff to shut down the Russian sales booth at Cannes in order to gather evidence about the shell company’s commercial activities that violated our intellectual property rights. The director of the shell company and his deputy both told the French bailiff that they worked for the Russian Ministry of Culture.

The Russian Ministry of Culture is now in the process of liquidating the studio with which we signed our agreement, showing no concern at all for the livelihoods and pensions of the 300 shareholders, most long-term employees of the animation studio.

#### *IPR violations and expropriation—to what end?*

It appears that part of the impetus for these copyright violations is the Ministry’s goal to establish a Soviet-type structure to funnel profits directly into the pockets of the film industry’s leadership. Currently, a state-owned entity, “Roskinoprokat,” is seeking to control all phases of the Russian feature film industry, from buying Kodak stock, to duplicating films for video and DVD, to producing Russian films, dubbing others into Russian, and controlling all cinema houses in Russia. All of the film studios have had to become state companies. Most have already had their libraries of films made during the USSR extracted from the production arms.

This desire to control all is what led the Ministry of Culture to destroy the successor of the studio with which we signed our contract. The expropriation of our property rights under this contract was another well-orchestrated step toward concentrating in the same hands all of the animation rights.

You will hear more about Roskinoprokat in the coming years because, as they openly state in interview after interview in Russia, the biggest plum is rights to distribute U.S. studio films, which generate the biggest profits in Russia. More than 100 modern movie theatres operate in Russia today, a number expected to triple in the next five years, with revenues predicted to reach \$100 million. Post-Soviet Russian films constitute only about 3 percent of the screen repertory and average \$200,000 at the box office. By contrast, American movies have proven to be very popular and very lucrative, grossing an average of \$2.8 million at the Russian box office.

The Minister of Culture and his Deputy have made clear that their goal is to consolidate everything into one big government-owned company. Roskinoprokat recently announced plans to open offices in Los Angeles this summer and is already hiring staff. One of their associates told me earlier this week that they believe it is only a "matter of time" before the major studios "succumb." The result will surely be a nightmare even worse than Sovexportfilm's monopoly on importing foreign films into the Soviet Union.

## II. THE USE OF "STATE INTERESTS" AND ILLEGAL EX-PARTE MEETINGS HINDER LEGITIMATE JUDICIAL REFORM EFFORTS IN RUSSIA

The importance of "state interests" in the application of law and administrative process in Russia raises critical separation of powers issues. In the Soviet tradition, courts and administrative powers, including enforcement agencies, pursue a mission related to state interests. They do not follow the Western norms of fair adjudication of law according to the facts and transparent procedures to implement rulings and otherwise conduct administrative process. In the Russian environment, state prosecutors operating under control of the executive branch define "state interests" in many judicial proceedings. Their very presence in a case frequently creates outcomes consistent with their objectives, rather than with the law and facts.

We unfortunately have experienced the illegitimate use of ex-parte meetings in court decisions. At the same time that the Russian Ministry of Culture was challenging our copyright in U.S. court, it was continuing in Russian courts to challenge the legitimacy of the animation studio that had contracted with us. After six rulings against the Ministry of Culture in the Russian courts, Ministry officials invited the Chief Justice of the Supreme Arbitrazh (or Commercial) Court to send a representative to a secret but well-documented "consultation" at the offices of Deputy Prime Minister Matviyenko. The purpose of the meeting was to secure for the new government-owned studio rights that belonged by law to the studio with which we signed our contract. No one from our side was invited of course, and such ex-parte meetings are against the law.

Attending the meeting on behalf of the government was Minister of Culture Shvidkoy, two of his deputy ministers, a Ministry of Culture lawyer, a representative of the State Property Ministry, two representatives of the State Prosecutor's Office, the director of the Russian patent bureau Rospatent, representatives of the Presidential Administration, director of the state-owned studio, and the chairman of Roskinoprokat.

This ex-parte meeting resulted in one cassation court decision and one Supreme Arbitrazh (Commercial) Court decision that together vacated all lower court rulings that had previously been decided against the Ministry of Culture. The effect of these decisions was that the properly registered successor of the company from which we gained our license was de-registered. It should be noted that in his declaration to the U.S. Federal Court, which I have submitted for the record, the respected Russian jurist Sergei Pashin concluded that the Supreme Arbitrazh Court decision was clearly inconsistent with both Soviet and Russian law and prior decisions made by the same court about the same matter, and that it had all of the markings of what is known in Russia as a "state ordered decision."

## III. RUSSIA DISREGARDS U.S. AND INTERNATIONAL ARBITRATION COURT DECISIONS

One of our contractual obligations was to defend the Russian studio's copyright against pirates in our distribution territory, which included the United States. In August 2000, while we were engaged in a lawsuit against a convicted felon for copyright violation in the U.S. Federal Court for the Eastern District of New York, the shell corporation set up by the Russian Ministry of Culture joined the suit as a third party on the side of the felon. Their objective in joining the suit against us in U.S. court was to attempt to gain a ruling that Films By Jove was not the legitimate copyright holder of the animation. The Ministry was thus tenacious in its organized campaign to undermine my company's rights, and we were unexpectedly burdened with enormous legal expenses in the effort to defend ourselves.

As it turned out, the Russian Ministry of Culture allied itself with the losing party in the U.S. district court: Films By Jove won the case. The felon with whom the Ministry had allied itself was arrested in December 2000 and subsequently pleaded guilty to pirating the intellectual property of the Motion Picture Association of America and the Recording Industry of America using master tapes and optical cassettes illegally manufactured in Russia. The Ministry's support for this convicted felon has never wavered.

On a related note, I also want to strongly urge the U.S. government and members of the international community to address Russia's failure to observe the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards. As several of my small business colleagues will tell you, Russian bailiffs do not enforce foreign arbitral decisions, even when ordered to do so by the Russian Supreme Court. I would be happy to provide examples of these cases if you so desire.

#### IV. THE U.S. GOVERNMENT MUST PLAY AN IMPORTANT ROLE IN ADDRESSING RUSSIAN IPR VIOLATIONS IN THE UNITED STATES

Russian IPR violations not only impact our business in Russia, they affect our business in the U.S. and in other countries. The losses I referenced earlier from the IIPA report on Russia do not include the massive additional losses caused by the import into the U.S., Germany and Israel—all countries with major populations of wealthy Russian immigrants—of illegally manufactured videos CDs, DVDs and software.

In the U.S., our government plays an important role in addressing IPR violations. For example, in December 2000 when the FBI arrested a Brighton Beach video pirate for piracy of the MPAA and RIA—the same one we sued in U.S. Federal Court—they confiscated truckloads of master cassettes and CDs imported from Russia. Unfortunately the pirate's arrest only resulted in a momentary lull in the violations of Russian and U.S. intellectual property by the Russian émigré community—and for that we have to look to our own legal system.

The pirate, Joseph Berov, opened his bootleg video business while on federal probation for importing Russian women into the U.S. for the purpose of indentured servitude. Yet two years after his arrest by the FBI and one year after he pleaded guilty, Mr. Berov has yet to be sentenced by the U.S. Federal Court for the Eastern District of New York. In the interim, he has opened two new superstores and resumed importing illegal video CDs from Russia. The message to his partners at the Ministry of Culture and the local émigré community is that "crime pays."

Other examples of Russian IPR violations in the U.S. include the Ministry of Culture's attempt last week to present the American Film Institute (AFI) with an animation program that violates both our license and the August 2001 U.S. Federal Court decision that we won. The same program included feature film rights that were legally licensed to legitimate U.S. distributors by the very Russian studios the Ministry agrees are the legal copyright holders. The AFI was vigilant and thus averted a major scandal. Two years ago, the American Cinematheque was less vigilant, and, with the Ministry of Culture, organized a tour of films without the consent of the legitimate producer (Mosfilm) of the films. The copyright holder was not consulted, not paid, and not even acknowledged.

#### *Conclusion*

I would like to close my testimony today by offering the following recommendations to the U.S. government, in order to address IPR violations in Russia:

- To continue to hold hearings such as this to raise awareness of IPR violations. In particular, these hearings should examine critical points of influence and leverage to curb Russian copyright violations. They should investigate the official role of Russian government agencies in IP piracy. They should consider why the state company Roskinoprokat, a self-proclaimed "child" of the Ministry of Culture, is being allowed to open an office in the U.S. and conduct commercial activity; and whether Roskinoprokat will be protected by the same sovereign immunity afforded the Ministry.
- To work with your colleagues in the U.S. Executive Branch (State Department, Commerce Department, USTR, etc.) to identify appropriate costs that could be imposed on Russia as a result of the disregard for the rule of law (treaty violations, expropriation cases, etc.);
- To support U.S. funding for rule-of-law initiatives in Russia, especially in the area of enforcement; and,
- To work with your counterparts in the Russian Congress ("Duma") to get a commitment to resolving these violations and disputes.

I want to thank the Subcommittee for giving me the opportunity to testify today, and I will be happy to answer any of your questions.

**Congress of the United States**  
Washington, DC 20515

March 15, 2002

The Honorable Valentina Ivanovna Matviyenko  
Deputy Prime Minister  
2 Krasnopresnenskaya nab.  
103274 Moscow  
Russian Federation

By Fax

Dear Deputy Prime Minister Matviyenko:

In 1992, Films by Jove (FBJ), a California-based film distribution company, signed a legally binding contract with the Russian studio Soyuzmultfilm (SMF), the holder of a copyright for a library of Soviet-era animation, to distribute these animation films outside of the former Soviet Union. At the time, SMF was in the process of being converted from state ownership to private ownership. The contract between FBJ and SMF applies California law to the relationship.

FBJ invested over \$4 million to restore, dub, and otherwise enhance the Soviet animation in order to make it accessible to the West, making a great contribution to Russian culture by successfully marketing and popularizing your heritage abroad. However, once the animation film project started to generate revenue for FBJ and SMF, Russian officials began efforts to retroactively void the FBJ contract. This issue has already been adjudicated in favor of FBJ by the United States District Court for the Eastern District of New York, which found that the 1992 agreement between FBJ and SMF was valid.

Regrettably, persuasive documents indicate that in the ongoing commercial dispute between the original SMF (with which FBJ has the contract) and a second state-owned Soyuzmultfilm incorporated in 1999, the Ministry of Culture -- together with the Office of the Prosecutor General -- appear to have inappropriately influenced the decisions of the Russian Arbitrazh Courts, including the High Arbitrazh Court, to favor the state-owned entity. These efforts, which have been justified by some officials as "protection of state interest," violate the constitutional separation of powers between the two branches of government, and directly harm the long-term investment of FBJ.

FBJ recently obtained a copy of a November 9, 2001 letter from Deputy Minister of Culture A. A. Golutva to the Embassies of the Russian Federation, in which Mr. Golutva falsely states that "all attempts to dispute legality of the existence and activity of the state-owned Soyuzmultfilm Studio in the courts were not crowned with success." He also instructs the Embassies to circulate information that "any usage of both films and trademark of Soyuzmultfilm, including usage in accordance with agreements concluded with lease enterprise Film Studio SMF or with other persons not authorized by state-owned Soyuzmultfilm Studio, are illegal." This letter has been used to undermine FBJ's credibility as a legitimate copyright holder.

and has caused substantive material damage to FBJ. We are alarmed because this appears to demonstrate that top officials at the Ministry of Culture are not committed to safeguarding the rights of American investors.

In addition, at a time when the U.S. and the Russian Federation are working together to curb piracy of American intellectual property in Russia, we are deeply concerned that the Ministry of Culture has allied itself in U.S. Federal Court with Joseph Berov, who previously pleaded guilty to importing women from the former Soviet Union into the United States for the purpose of indentured servitude, and who recently pleaded guilty to pirating the intellectual property of the Motion Picture Association of America (MPAA) and the Recording Industry of America (RIAA). Mr. Berov pirated the MPAA and RIAA using master tapes and optical cassettes illegally manufactured in Russia.

We consider the activities of the Russian officials connected to the case, including Culture Minister Mikhail Shvidkoy, contrary to President Vladimir V. Putin's repeated statements urging new foreign investment in Russia. President Putin has requested the U.S. government to encourage American investors to take a new look at Russia, pledging that under his administration investors will be guaranteed a level playing field, adherence to the rule of law, an independent judiciary, and no government interference in third party contracts.

In the near future we may propose Congressional hearings on intellectual property protections in Russia and the FBJ case. Such hearings could have an impact on the U.S. government's support for new investment in Russia, Russia's membership in the World Trade Organization, as well as the ability of the new Russian government-owned company Roskinoprokat to license distribution rights to major American films, a goal publicly articulated by Mr. Golutva. It appears that many of the Russian officials involved in Roskinoprokat are the same who are trying to illegally cancel the FBJ contract and damage that company's investment.


Ms. Deputy Prime Minister, we have no doubt that you are committed to the protection of foreign investors' rights and the development of Russia's business ties with the U.S. and the world. Unfortunately, it appears to us that some ministers and deputy ministers under your purview may have inappropriate personal and financial interests in the outcome of the cases and in the cancellation of the FBJ contract.

We therefore urge you instruct the Ministry of Culture, and specifically Msrs. Shvidkoy and Golutva, to recognize the lawful ownership of the distribution rights of the Soviet-era animation by FBJ, and meet with the U.S. Embassy officials and representatives of FBJ to discuss the formal conclusion of this conflict in the fashion satisfactory to the American investor.

Sincerely,

  
HOWARD L. BERMAN  
Member of Congress

  
CURT WELDON  
Member of Congress

  
HENRY A. WAXMAN  
Member of Congress

cc: Minister of Culture Mikhail Shvidkoy

# Congress of the United States

Washington, DC 20515

May 21, 2002

The Honorable Valentina Ivanovna Matviyenko  
Deputy Prime Minister  
2 Krasnopresnenskaya nab.  
103274 Moscow  
Russian Federation

Dear Deputy Prime Minister Matviyenko:

On March 15, 2002 we wrote to you about inappropriate and apparently illegal efforts by the Ministry of Culture to retroactively cancel the legitimate and long-term investment of the American company Films by Jove (FBJ). To date we have not received a response.

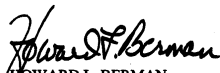
FBJ has informed us that representatives of the Unitary Soyuzmultfilm (SMF) did meet with them at the Cannes TV Market on April 15 and reached an agreement by which the two companies could work in the future. This agreement included the Unitary SMF's recognition of FBJ's long-term contract – an assurance that would also be required from the Ministry of Culture. However, since returning to Moscow other parties in the Ministry of Culture's legal department have apparently blocked the Unitary SMF's ability to conclude the agreement.

In addition, FBJ informs us that Unitary SMF Director Ernst A. Rahimov, upon learning that the Unitary SMF had lost the U.S. Federal Court case in New York, stated that the Unitary SMF had never agreed to become a party in the case, and had never given any lawyer the authority to represent the Unitary SMF. He apparently also stated that the copyright to films produced during the USSR belongs to the studios, the same position taken by Mosfilm and Lenfilm when they filed a suit in the same U.S. Federal Court on May 1, 2002. The lawyer allegedly representing the Unitary SMF before Judge Trager has based his entire case on the Unitary SMF's "position" that copyrights belong to the state.

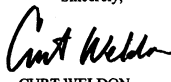
These events create an impression that some individuals in the Ministry of Culture are apparently providing misleading information to the U.S. Federal Court which is antithetical to Russian law, President Putin's decree No. 309 of April 4, 2001, and the Unitary SMF's own legal position. This undermines Russia's ability to distribute its cultural treasures in the United States and other parts of the world, and needlessly damages Russia's reputation in the eyes of the U.S. Congress, the U.S. court system and organizations such as the WTO.

Representatives of Films by Jove will be in Moscow from May 28-31. We urge you to meet with them and bring this unfortunate matter to a speedy conclusion.

Sincerely,



HOWARD L. BERMAN  
Member of Congress



CURT WELDON  
Member of Congress



HENRY A. WAXMAN  
Member of Congress

Cc: Mikhail Shvidkoy, Minister of Culture  
Dmitri N. Kozak, Deputy Head of the Presidential Administration  
Andrei Sharonov, Deputy Minister of Trade

UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF NEW YORK

-----  
FILMS BY JOVE, INC. and  
SOYUZMULTFILM STUDIOS,

CIVIL ACTION NO. 98-7674

Plaintiffs,

-against-

DECLARATION OF  
SERGEI ANATOLIEVICH  
PASHIN

JOSEPH BEROV, NATASHA ORLOVA,  
THE RIGMA AMERICA CORPORATION, ,  
SAINT PETERSBURG PUBLISHING HOUSE  
AND GROUP, FEDERAL STATE UNITARIAN  
ENTERPRISE SOYUZMULTFILM STUDIO,  
WIDNES ENTERPRISES, DEANDOWN, LTD.,  
RUSCICO, ARSEN BABAYAN, ERNST  
AHMEDOVICH RAHIMOV, AKOP  
GURGENOVICH KIROKASYAN and ROMAN  
DIKTYAR,

Defendants.

-----X

I, Sergei Anatolievich Pashin, declare:

1. This opinion is provided by Sergei Anatolievich Pashin, who holds a Ph.D. in Law and is an Honorary Attorney of the R.S.F.S.R. [Russian Soviet Federation Socialist Republic], a retired Federal Judge of the Moscow Municipal Court, and is currently a Professor at the Moscow Institute of Economics, Politics and Law (School of Law).

**EXPERT QUALIFICATIONS**

2. Expert qualifications sufficient for providing expert conclusions on the above-mentioned issues is supported by the following credentials:

**Research**

3. In 1984 S.A. Pashin graduated with honors from the Moscow State University named after Lomonosov, M.V., where he was a full time student, majoring in legal studies. From 1984 until 1987 he was a postgraduate student at the same University.

4. In 1987 S.A. Pashin presented and successfully defended a thesis, which enabled him to receive a Ph.D. in Law. In 1987 S.A. Pashin, was awarded a Ph.D., specializing in "Court systems-Criminal Justice-Supervision by the State Prosecutors." In 1995 he received a research title of Assistant Professor.

5. In 1987-1990 S.A. Pashin was a Professor at the Law School of the Moscow State University. Among the courses he taught were "Trial and Justice," "The Fundamentals of the Theory of Justice."

6. In 1992 and 1993 S.A. Pashin had an opportunity to gain additional experience in the United States, studying in Boston and in Washington, DC, and learning



about the Federal and State Judicial Systems, the multi-level Court system: criminal, civil, and juvenile.

7. From 1992 until 1995 S.A. Pashin taught law to judges during advance training sessions held at the Institute of Justice under the Law Academy of the Ministry of Justice of the Russian Federation.

8. From 1995 until 1999 he taught the fundamentals of the law of proof to Prosecutors at the Advanced Training Institute for Senior Officials of the Attorney General's office of the Russian Federation.

9. S.A. Pashin is the author of over 100 research articles and books on judicial reform, law of proof, and theory of justice. Among his works are the following: Practical Guide to the Arbitrazh Court System "Claims and Grievances" (as a co-author), "The Judicial Reform and the Jury" (a monograph, 1994, 1996), "The Fundamentals of Law" (a two volume textbook, 1997), "Proof in the Russian Criminal Process" (a monograph, 1998), "Court Ethics" (a book, 2001).

10. In March to June 2001 S. A. Pashin was a visiting fellow at the John W. McCormack Institute of Public Affairs (University of Massachusetts, Boston) and lectured on issues of Russia's law and court reform at the Massachusetts State University and New York University, Harvard University and Yale University.

11. Since 2001 S.A. Pashin has been a professor at Moscow Institute of Economy, Politics and Law.

State Service

12. In 1990 S.A. Pashin was a senior consultant in the cabinet of the Supreme Court of the Soviet Union. He was responsible for systematizing criminal and civil law and preparing official responses to Bills submitted to the Supreme Court of the Soviet Union.

13. From 1990 until 1992 S.A. Pashin served as the chief specialist of the Legal Department of the Presidium of the Supreme Council of the R.S.F.S.R. At that time he was responsible for the development and editing of Bills, which primarily dealt with the judicial reform. He also participated in the development of the R.S.F.S.R bill "On the Arbitrazh Court" (passed on 07.04.1991) and its updated version, in the making up of the first Arbitrazh Procedural Code of the Russian Federation (approved on 03.05.1992). Moreover, Pashin was responsible for preparing documentation for joint meetings of the Committees on Law, Legality and Human Rights when the said Committees discussed prospective nominees for the positions of judges.

14. From 1990 until 1995 S.A. Pashin was employed as the head of the department dealing with the judicial reform within the Administration of the President of the Russian Federation. Pashin was responsible for the preparation of Bills and drafts of

Presidential Decrees, editing Bills and drafts of Presidential Decrees, and for the approval of the drafts of Decrees and Presidential Orders, for the submission of proposals to implement the Constitutional Authority granted to the President of the Russian Federation (for instance, the right to veto). Pashin participated in the preparation of the currently effective Federal Constitutional Law enacted on April 28, 1995, entitled "On Arbitrazh Courts in the Russian Federation", and also participated in the preparation of Arbitrazh Procedural Code of the Russian Federation of May 5, 1995, and also of norms included in 1993 Constitution of the Russian Federation, which are related to the justice system. In addition, Pashin was responsible for examining documents received from the Ministry of Justice of the Russian Federation pertaining to the nominees for the posts of judges, submitting his opinion to the Presidential Appointment Committee, preparing drafts of Presidential Decrees. The Judicial Reform Department was responsible for establishing new institutions of legal procedure, for instance, for the establishment of jury court procedures, for summarizing legal practice and promoting professional training among judges. To ensure professional training among judges Pashin organized a group of over 200 judges and sent them to the United States, Great Britain and Austria for an exchange visit.

15. In 1995-1996 S.A. Pashin was employed as Deputy Head of the Legal Department of the State Duma and Federal Council of the Russian Federation. Pashin was responsible for preparing models for decrees for States members of the CIS.

16. In 1996-2001 S.A. Pashin retained the position of the Federal Judge of the Moscow Municipal Court.

The Development of the Legal System

17. Pashin is one of the authors of the Judicial Reform Concept in the R.S.F.S.R., approved by the Supreme Council of the R.S.F.S.R. on the introduction of as the of the R.S.F.S.R. President B.N. Yeltsin on October 24, 1991.

18. He was the sole author of the first law in the history of Russia "The Constitutional Court of the R.S.F.S.R." (approved in the author's version in 1991).

19. He was the primary author of the law "The Status of Judges in the Russian Federation" (adopted in 1992).

20. He led the working group on the development of the legal system and the jury system and was the author of the procedural aspects (the law was passed in 1993).

21. He headed the working group on the development of draft Federal constitutional law "The Court System in the Russian Federation" (Adopted in 1996).

22. In the last three instances, S.A. Pashin was appointed the representative in Parliament of the President of the Russian Federation, who in turn proposed laws to the Supreme Council of the Russian Federation as his legislative prerogative and after the dissolution of the Council to the State Duma of the Federal Council of the Russian Federation.

#### Awards

23. For his significant part in the development of the Judicial Reform Conception in the R.S.F.S.R., S.A. Pashin was honored with the Order of the President of the Russian Federation and awarded the honorary title of "Honorary Attorney of the R.S.F.S.R." (1992).

24. For his public service S.A. Pashin was awarded the prize "For the Protection of Human Rights" and the title of Authorized Official Protecting Human Rights in the Russian Federation (1999).

#### Public Service

25. S.A. Pashin took part in the legal defense of the Center "Judicial and Legal Reform", Center for the Promotion of Criminal Justice, the Taganrog Society for the Protection of Human Rights, he is also a member of the Independent Expert and Legal Council and of the Moscow Helsinki Group.

**CONTENT OF THE OPINION**

*The December 18, 2001 Decision of the High Arbitrazh Court of the Russian Federation*

26. In its December 18, 2001 decision, the Presidium of the High Arbitrazh Court of the Russian Federation ("High Arbitrazh Court") stated that the Joint Stock Company "Kinostudio "Soyuzmultfilm" into which the lease enterprise "Kinostudiya mul'tiplikatsionnykh fil'mov" was converted, "is not the successor of rights of the state enterprise "Kinostudio "Soyuzmultfilm" because "The leased property complex..., was not privatized, and with the creation of the joint stock company it has remained state property. ...With the expiration of the lease agreement term, the plaintiff had no longer any legal grounds for using rights and property that were obtained under this agreement."

27. In making its ruling the High Arbitrazh Court also stated that, "...not a state enterprise but an independent legal entity - such as an organization of lessees created by a labor collective of a state enterprise - is converted into a lease enterprise."

28. In making said statement the High Arbitrazh Court tried to make it appear as if the state enterprise did not transform into the lease enterprise. The statement that an organization of lessees created by a labor collective, not a state enterprise, is converted into a lease enterprise might be interpreted to mean that the involvement of an

organization of lessees somehow affects the undeniable fact that the state enterprise transformed into the lease enterprise.

29. An organization of lessees is merely the workers of the lease enterprise. Said parties execute documents authorizing the transformation. It is a merely ministerial middle step in the transformation from state enterprise to lease enterprise. It does not affect the fact that the state enterprise transformed into the lease enterprise and the state enterprise ceased to exist thereafter. Tens of thousands of state enterprises have been transformed in the same manner.

30. The High Arbitrazh Court used an unprecedented and illogical judicial construction because the lease enterprise could not have inherited any assets from the organization of lessees because it was created by the collective for the sole purpose of signing the agreement with Goskino. All rights that the lease enterprise inherited would have been inherited from the state enterprise.

31. Said statement and the High Arbitrazh's glaring failure to explain the fate of the State Enterprise over ten years (after the Lease Enterprise was created) raise questions regarding the integrity of said decision.

32. The analysis of the legislation from the end of 1989 leaves no room for doubt that: First, the State Enterprise SMF was transformed into the lease Enterprise SMF according to the wishes of the general conference on signing a lease contract dated

Dec 20, 1989 between Goskino (lessor) and the collective of the Studio (lessee) followed by the State Registration on December 14, 1990.

33. Secondly, at that moment the State Enterprise lost its quality as a juridical person and ceased to exist.

34. The law of the Russian Federation ("RF") of December 25, 1990 on Enterprises and Entrepreneurship states that an enterprise can be created by the resolution of the labor collective of a state enterprise (Part 1, Article 33 of the Law) into the organizational and legal form of a Lease Enterprise (Part 1, Article 15 of the Law). When the transformation of a state enterprise into "another legal and organization form" happens, the enterprise ceases to exist (Part 1, Article 37 of the Law); "all the property rights as well as obligations of the previous enterprise will go to the newly formed enterprise" (Part 8, Article 37 of the Law).

35. After the transformation into a Lease Enterprise the State Enterprise cannot exist, neither as an Enterprise or another juridical person. After the transformation, it ceases to be an independent commercial entity producing a product or providing services or labor, which means it does not fall within the definition of an enterprise contained in Part 1, Article 4 of the Law of the RSFSR of December 25, 1990. At that exact moment it also loses all the qualities of the juridical person established by Article 23 of the Civil Code of the Russian Federation of 1964, i.e. ownership of defined



property, ability on its behalf to acquire rights and fulfill obligations, be a party to court arbitration or third party mediation court.

36. The position of the High Arbitrazh Court in its December 18, 2001 decision appears to be inconsistent with the position that the courts of general jurisdiction as well as the High Arbitrazh Court itself have previously taken about related questions. For instance, when considering the complaints of employees fired at the time of transfer of a state enterprise into lease enterprise by the labor collective, the courts of general jurisdiction of different levels concluded that in such cases, the reorganization of such enterprises took place in the form of transformation from one organizational legal form into another. As a result the former employees of such former state enterprises had the right to continue labor relations with the newly formed lease enterprise (note Bulletin of the Supreme Court of the Russian Federation No 12, 1993 signed by Judge A.K. Gavrilin titled "Court decisions overturning termination decisions made by the management of private and reorganized enterprises.")

37. In the decision of the High Arbitrazh Court of January 23, 2001 No. 5527/00, signed by the same judge who signed the December 18, 2001 decision, the court stated unequivocally that the state enterprise for design, remodeling and construction "Mosoblremstroy" transformed into a lease enterprise PPRS "Mosoblremstroy." In that case the law was implemented according to its actual meaning. The Court stated that the state enterprise, not the organization of lessees, was transformed into a lease enterprise.

It its decision of December 18, 2001 the High Arbitrazh Court inexplicably took a different position.

38. This hurried change by the High Arbitrazh Court of its own legal position leads one to think there was a distortion in this case of the legal framework in favor of the interests of the organs of executive power. In Russia this phenomena is called “an ordered judicial decision.”

39. In view of the foregoing, the legality of the December 18, 2001 decision of the High Arbitrazh Court appears doubtful. Omissions by the High Arbitrazh Court, as well as use by the court of illogical and entangled judicial constructions, resulted in a decision which allowed the organs of the executive branch to interpret this decision in any manner they deemed fit which would be for the purpose of protecting what is specifically understood to be “state interest.”

*Specific understanding of the “state interest” by a Russian court.*

40. The way a “state interest” is understood in Russia’s highest bodies of state power, is seen from the copy of an office memo addressed to one of the executives of the High Arbitrazh Court, A. A. Arifullin, written by the Senior consultant of the Administration of Generalization of Judicial Practice E. A. Lyubichev who was present at the March 30, 2001 consultation meeting at offices of the Deputy Chairman of the

Russian Federation Government V.I. Matvienko. A copy of said memo is annexed to the Declaration of Larissa Riabchenko as Exhibit 1.<sup>1</sup>

41. At the meeting, “a wish was expressed about the necessity by all state bodies to secure the protection of interests of the Russian Federation (the Federal State Unitarian Enterprise “Kinostudio “Soyuzmultfilm”).” As it is seen from the preamble and the remainder of the text of the decision made at the March 30, 2001 consultation meeting at the offices of the Deputy Chairman of the Russian Federation Government, V.I. Matvienko, annexed to the declaration of Larissa Riabchenko as Exhibit 2, the securing of a state interest is linked to the securing of the activity of the FSUE “Kinostudio “Soyuzmultfilm.” Thus, the state interest was linked by governmental organs of Russia with the interests of a federal state unitary enterprise which, according to Law is only one of many equal subjects of commercial activity.

42. According to Part 2, Art. 8 of the Russian Federation Constitution, “Russian Federation recognizes and equally protects private, state, municipal, and other forms of property.” The Federal Constitutional Law of April 28, 1995, “On Arbitrazh Courts in the Russian Federation,” among the basic principles of the activity of Arbitrazh courts points out “the equality of organizations and civilians before the law and the court” (Art. 6.) “Justice in an Arbitrazh court is performed

<sup>1</sup> I am informed that this document along with the document annexed as Exhibit 3 to the declaration of Larissa Riabchenko (an actual photocopy later obtained from Goskomimushchesvo of the RF) were found in the supervisory court file by Larissa N. Riabchenko and Ms. Riabchenko was not allowed to make photocopies therefrom. Pursuant to the 1995 Russian law, Ms. Riabchenko should not have been denied permission to photocopy documents from said file.

based upon the equality before the law irrespective of location, subordination, and the form of property,” says Art. 6 of the Arbitrazh Procedural Code of the Russian Federation. Item 1 of the Decree of the Plenary Session of the High Arbitrazh Court No. 8 of February 25, 1998, “On some issues of the practice of resolution of disputes concerned with protection of property right and other material rights,” says that “...The rights of ownership, use and disposal of their property of all property owners are subject to court protection in equal manner.”

*Violation of the principle of independence of judicial power*

43. The participation of a representative of the highest level body of judicial power “in resolution of economic disputes and other issues in consideration by arbitrazh courts” (Art. 127 of the Russian Federation Constitution) in a consultation meeting organized at the highest level body of executive power, in order to discuss, in particular, the specific issues being considered by arbitrazh courts in a specific case and to develop recommendations to the General Prosecutor’s Office of the Russian Federation and the High Arbitrazh Court (Items 6 and 7 of the decision of the consultation meeting at the Deputy Chairman of the Russian Federation Government V. I. Matvienko), makes doubtful the impartiality of both the High Arbitrazh Court and lower arbitrazh courts, in their consideration of cases in question, and is an unlawful form of “collaboration” between the bodies of judicial and executive power, and it violates the principle of division of authorities proclaimed in Article 10 of the Russian Federation Constitution.

44. A High Arbitrazh Court representative's participation in such a consultation meeting violates Provisions of Part 1, Art. 5 of the Federal Constitutional Law of December 31, 1996, "On Legal System of the Russian Federation," which states that "Courts perform judicial power independently, not dependent of anyone's will...".

45. Part 4, Art. 3 of the Code of Honor of the Russian Federation Judge (approved by the 2nd All-Russian Congress of Judges and adopted by the Council of Judges of the Russian Federation on October 21, 1993) allows judges to enter into contact in some form, including through intermediaries from the cabinet of judges, "with bodies of legislative and executive power or their officials, regarding issues of law, the legal system, or performance of justice but during such contacts no pressure can be exerted on a judge in relation to his performance of his professional duties and doubts do not rise regarding his impartiality." Violation of the code of judges' ethics is a misdemeanor that entails, pursuant to Art. 121 of the RF Law of June 26, 1992, "the Status of Judges in the Russian Federation," legal accountability including the termination of judiciary powers.

*Exertion of Influence on Performance of Justice*

46. In this case, the Chairman and other judges of the High Arbitrazh Court appear to have been pressured by the Deputy Chairman of the Russian Federation

Government. The exerted pressure exhibited by Item 7 of the decision of the consultation meeting on March 30, 2001 at the office of the Deputy Chairman of the Russian Federation Government, at which Senior Consultant of the High Arbitrazh Court's Administration of Generalization of Judicial Practice E. A. Lyubichev was given an "assignment" for High Arbitrazh Court Chairman V. A. Yakovlev (the same judge who rendered the December 18, 2001 decision). The suggested "assignment" was that Chief Justice Yakovlev should "carry out, in procedural forms established by law, court supervision over the cases in consideration by Arbitrazh Courts of Moscow and Moscow Circuit re: the appeals of the FSUE "Kinostudio "Soyuzmultfilm," the Moscow Region Prosecutor's Office, and the JSC "Kinostudio "Soyuzmultfilm." These measures are placed in the context of efforts by the bodies of executive power (Ministry of Culture of the Russian Federation, Ministry of Property of the Russian Federation, the Department of the Russian Agency for Patents and Trademarks "Rospatent", the General Prosecutor's Office of the Russian Federation) "to secure the activity of the FSUE," as if the High Arbitrazh Court was treated, not as the independent body of judicial power that it is supposed to be, but as if it was some mid-level department, one of, as it is said in the preamble to the decision, "the interested state organizations."

47. Such actions by the Deputy Chairman of the Russian Federation Government conflict with the provisions of Part 1, Article 120 of the Russian Federation Constitution, Part 2, Article 1 of the Federal Constitutional Law of December 31, 1996 "On Legal System of the Russian Federation," Article 6 of Federal Constitutional Law of

April 28, 1995 “On Arbitrazh Courts in the Russian Federation” which declare independence of the bodies of judiciary power from the bodies of executive powers.

*Replacement of the Judiciary Supervision by Administrative Control*

48. Another telling fact is also included as part of Item 7 of the decision of the consultation meeting of March 30, 2001 which presses the Chairman of the High Arbitrazh Court to perform improper actions. According to Art. 127 of the Russian Federation Constitution, Articles 9, 10, 15, 20 of the Federal Constitutional Law of April 28, 1995 “On Arbitrazh Courts in the Russian Federation,” neither the Chairman of the High Arbitrazh Court, nor any other official of the said court, is endowed the right to carry out “court supervision over cases in consideration by Arbitrazh Courts of Moscow and Moscow Circuit,” because such actions are deemed as unlawful interference into the court’s activity (Part 5, Article 5 of the Federal Constitutional Law of December 31, 1996 “On the Legal System of the Russian Federation.”) Bringing forth the protest as a matter of supervision and consideration of a case as a matter of supervision at the High Arbitrazh Court are solely possible upon the completion of court proceedings in the lower courts and only after the lower courts decisions take effect.

49. It is clear that in this case the term “court supervision” acted as a euphemism for the concept of “control” which is confirmed by the use of the word “control” in the office memo of the High Court Senior consultant E. A. Lyubichev (Exhibit A) when he writes that at the consultation meeting at the Deputy Chairman of the Russian Federation Government “a wish was expressed about... the reinforcement of control on behalf of the General Prosecutor’s Office and the High Arbitrazh Court of the Russian Federation over the decisions of the said courts.”

*The Potential Effectiveness of Interference by a High-Level Official of the Russian Government into Court Activity*

50. All arbitration courts without exception acting on the Russian Federation territory (including those called arbitration courts for regions, krais, and other subjects of the Russian Federation) belong to the category of federal courts that act within the framework of the centralized court system under the jurisdiction of the Higher Arbitrazh Court. All Arbitrazh courts judges are appointed in Moscow. “The courts are financed only from federal budget...” (Article 124 of the Russian Federation Constitution). Similarly the court system of the general jurisdiction is structured, in which only the lowest level, the justice of the Peace, is not considered federal, yet is it still supported by the federal budget.

51. In consideration of economic disputes, no priority should be given to the state and those in possession of its property. Pursuant to Part 2, Article 8 of the Russian



Federation Constitution, "Russian Federation equally recognizes and protects private, state, municipal, and other property forms." The Federal Constitutional Law of April 28, 1995 "On Arbitrazh Courts in the Russian Federation" among the fundamental principles of the arbitrazh court activities names "the equality of organizations and citizens before the law and court" (Article 6.) "Justice in the arbitrazh court is implemented on the basis of equality of organizations before the law and the court regardless of the location, subordination, and property form," says Article 6 of the current Arbitrazh Procedural Code of the Russian Federation. Item 1 of the Decree of the Plenary Session of the Higher Arbitrazh Court of the Russian Federation No. 8 of February 25, 1998 "On some issues of the practice of resolution of disputes concerned with protection of property right and other material rights," says that "...The rights of ownership, use and disposal of their property of all property owners are subject to court protection in equal manner."

52. But in fact, there are reasons to presume that, especially after the suspension of court reform in 1995-1996, the courts began in some cases to pursue goals others than those in interest of the law, and adopted an orientation to the priority protection of narrowly understood state interests. From the Soviet period, the term of "telephone law" has been preserved. There are several reasons for it.

53. Arbitrazh courts were formed after the adoption of the R.S.F.S.R. Law of June 4, 1991, "On Arbitrazh Court" on the basis of the so-called State Arbitrazh of R.S.F.S.R. which was designed to resolve administratively (not judicially) disputes between socialist enterprises, with an implied objective of the priority guarding of the

Soviet State's interests and protection of "all-nation" (which again is the state's) property. The chairmen of arbitrazh courts, their deputies, and other judges for the most part were formerly employed as state arbitrators and have up to the present time preserved their former orientation.

**54. The following fact could not but leave an imprint on the judges' minds which is that until August 7, 2000, the tasks of civil legal proceedings were recognized as the protection "of the Socialist economic system and Socialist property" (Part 1, Article 2 of the R.S.F.S.R. Civil Procedural Code), and judges were instructed to resolve "civil cases based on law, in accordance with the socialist sense of justice" (Article 7 of the R.S.F.S.R. Civil Procedural Code).**

55. The current generation of Russian lawyers who have influential posts in the bodies of executive authority and non-prestigious court duties, have been raised in the spirit of the Soviet law, permeated by the idea of priority of state interest and will and state property over that of private property. The expression "private property" was risky to use for a career in social sciences even during "Perestroika" of 1985-1990. Until August 7, 2000, the tasks of civil legal proceedings were recognized as the protection of the Soviet social system, "socialist economic system and socialist property" (Part 1, Article 2 of the R.S.F.S.R. Civil Procedural Code, and judges and jurors were instructed to resolve "civil cases based on law, in accordance with the socialist sense of justice" (Article 7 of the R.S.F.S.R. Civil Procedural Code). This state approach is perpetuated by judges without any outside interference into their activity, simply by inertia.

56. According to Articles 44 and 46 of the Federal Constitutional Law of April 28, 1995, "On Arbitrazh Courts in the Russian Federation," Articles 30 and 33 of the Federal Constitutional Law of December 31, 1996, "On Legal System of the Russian Federation," the procurement of the activity of the whole system of Arbitrazh courts is placed upon the High Arbitrazh Court which depends on the Russian Federation Government for its allotment of budget items concerned with funding of the Arbitrazh courts.

57. The funding and procurement of Russian courts since 1917, has never been sufficiently adequate. In 1995-2000 the courts received from federal budgets the sums that covered no more than 30-40% of their expenses. In 2001, for the first time in the post-Soviet period, half of the budget request of the court system was satisfied. Court chairmen, including the heads of the Supreme Court of the Russian Federation and the Higher Arbitrazh Court, are interested in maintaining friendly relations with the authorities, especially because the judges and the staff of the aforementioned higher courts, while being on a relatively modest salary, receive far greater benefits (such as company cars, summer houses, low cost vacations at resorts, service in Kremlin hospitals and clinics for themselves and their families, clothing at special tailor's shops, passes to the exclusive cafeteria on Ilyinka street, and apartments) from the hands of the officials of the Russian Federation President's Administration.

58. **Court chairmen** appointed to this post for life have enormous power over regular judges and they use that power extensively in selecting their staff or forcing judges who do not compromise with their conscience, to leave or be laid off on defamatory grounds; and in arbitrarily distributing the cases. The court chairmen determine whether a judge is promoted, whether his family moves from a dorm to a separate apartment in the near future, whether he takes his vacation in the summer or winter.

59. Not by chance among the proposals to revive court reform, discussed today in Russia, that much thought is given to the following: improving courts funding, renovating court buildings (700 of which have been deemed dangerous because of possible collapse), limiting the term of court chairmanship for a judge to five years, introducing into the judges collegium judges who resolve issues of termination of judges' authorities and representatives of public rights activists.

Based on the aforementioned, I come to the following *conclusion*:

60. There are solid grounds to conclude that the ruling of the High Arbitrazh Court No. 8137/00 of December 18, 2001 was made in violation of the principle of the division of powers proclaimed in Article 10 of the Russian Federation Constitution, and that the highest bodies of executive power of the Russian Federation attempted to meet their demands of protection of the specifically understood "state interest" by pressuring the highest bodies of judicial power of the Russian Federation. The unlawful pressure

exerted on Chairman of the High Arbitrazh Court as represented, by a high-level official of the Russian Federation Government in the interests of the Federal Unitarian Enterprise "Kinostudio Soyuzmultfilm," was likely to have influenced the Court's decision.

61. Hence, there are also grounds for doubt that in the present case the requirements of Part 1, Article 14 of "the International Pact on Civil and Political rights" of fair consideration of civil cases by "independent and impartial court" (which are integral part of Russian judicial system in conformity with Part 4, Article 15 of the Russian Federation Constitution) have been observed.

I, Sergei A. Pashin, hereby declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed this \_\_\_\_ day of May, 2002 at Moscow, Russia.

\_\_\_\_\_  
Sergei Anatolievich Pashin

Signed Original Submitted to U.S. Federal Court

Mr. SMITH. Thank you, Ms. Vidov.

I just want to say to you that those bells did not indicate your time was up. That was just to indicate that we're going into session in 15 minutes. So don't take that too personally.

Ms. VIDOV. Thank you.

Mr. SMITH. Before I begin my questions, I just want to thank the Members who are present for their attendance. This Subcommittee consistently has the best attendance of any Subcommittee I've been associated with, and I just appreciate the Members taking the time to come and being interested in the subject matter as well.

Mr. Malcolm, let me direct my first comment, not question, toward you and just say that I appreciate the progress the Depart-

ment of Justice is making. You mentioned dozens of prosecutions and convictions. My only hope is that they will increase.

Certainly, the problem is increasing, and I hope that your activity and effort and determination will increase proportionately. And so, I wish you well in that regard.

Mr. MALCOLM. Thank you.

Mr. SMITH. I wanted to ask you a question, and this goes to a statement you made on page 15 of your prepared remarks.

You say that organized crime syndicates are frequently engaged in many types of illicit enterprises, including supporting terrorist activities. What would be some examples of that? Or how serious is that connection between the piracy and the terrorist activities?

Mr. MALCOLM. Well, it's difficult for me to give you a precise number of specific examples. Let me say, Mr. Chairman, that it would surprise me greatly if the number were not large, as Mr. Valenti has stated. This is an easy enterprise in which to enter. The barriers to entry are very small. The profits are huge.

There are worldwide distribution networks, and one can make perfect digital copies in a matter of moments and distribute them throughout the world with a few clicks of a mouse. And the dollars are very large, and these illicit organizations are looking to raise money, as much money as they can, as quietly as they can, and as quickly as they can.

Now that having been said, CCIPS works very closely with our international partners on all manners of Internet theft and piracy, hard goods in general, and the Counterterrorism Section, of course, is actively involved in looking at the distribution of any commodity, including pirated goods, that would aid and support terrorist organizations.

Mr. SMITH. Okay. Thank you, Mr. Malcolm.

Mr. Valenti, on page 3 of your testimony, you have a nice turn of phrase that I want to read, but I want to ask you a question after that.

You say, "The mysterious magic of being able with a simple click of a mouse to send a full-length movie hurtling with the speed of light to any part of the planet is a marketing dream and an anti-piracy nightmare."

And that is certainly true. I know you've been asked this question many times before, but it still might be enlightening for all of us to hear your response, and that is we know the increasing problem of international piracy and domestic piracy. And yet, we continue to set box office records.

Why is that, and what's your concern about the future? And is there—in other words, you can see if we're setting box office records, why is there such a great concern?

Mr. VALENTI. We did set box office records in 2002, the largest box office in the history of the movie industry, and more people went to the movies since 1957.

That's to the theaters, which is the right way to see a movie. It's an extraordinary experience. With unknown companions of a single night and having in a darkened theater this movie explode on you, and you just—you just think it's wonderful.

However, only 2 out of 10 movies ever get their money back from theatrical exhibition. They must go to other venues—to premium

cable, to television, to basic cable, and to international. Because last year, I might add, while we had all-time box office records, the average cost of the 225 movies made by the seven major studios, the average cost to make and market a U.S. movie was \$90 million.

Now, I realize with the deficits and everything else, that may not seem much. But to us, that's serious money, to quote Senator Dirksen.

And I think it's a serious problem because if you have your movie abducted, kidnapped, and then sent all over the world while it's in theatrical exhibition, you then set into decay and kind of send it into atrophy, which, by the way, I've been looking for a way to use that word "atrophy" for a long time. [Laughter.]

Mr. VALENTI. Thank you for letting me do it. It is sucking the blood out of our business in the future.

Now I have to tell you that I am an optimist. I truly believe, I truly believe and am confident that in time we will find the technological means and other means, including the help of the Congress, to put a stop to this piracy or at least bring it down to tolerable levels where we can sturdily protect our movies.

But, as I said, if we just depended on box office revenues, this movie industry would be in a state of anemia.

Mr. SMITH. Thank you, Mr. Valenti.

One other question. You mentioned in your prepared remarks, but not your oral testimony that today you will be launching an entertainment industry coalition for free trade. What do you hope to accomplish with that?

Mr. VALENTI. Well, I'm a great believer in open trade with all countries. There is a kind of a theory that abounds in a lot of foreign countries. They believe that if they can barrier, exile, shrink, or otherwise restrict the American movie from coming into their country that their own movie industry will spring like Athena from the forehead of Zeus and prosper mightily. Of course, it's a defunct mythology that doesn't work, but it is still there.

Over 40 percent of all the revenues that fortify the American film industry come from international revenues, come from international sources. So that open trade, keeping the lines of communication and trade open between countries is very important to us.

And Ambassador Zoellick, the U.S. trade representative, will be a part of that launching, as will be a number of senators and congressmen. I think it's a very, very important coalition that we're building.

Mr. SMITH. Okay. Thank you, Mr. Valenti.

Mr. LaMagna, you mentioned that you feel that Federal law does not provide adequate civil and criminal remedies to combat trafficking in genuine physical components or in the combining of stolen components with counterfeit CD-ROMs and packaging. The loophole in existing Federal law makes it very difficult for prosecutors to target those persons who clearly facilitate counterfeit sales.

I'd like for you to be more specific as to where we have the loopholes in the law, and I'd also like Mr. Malcolm to respond to your assertion that we really don't have the legal tools that we need and tell us why not.

Mr. LAMAGNA. Thank you, Mr. Chairman. What we have in our business, sir, are people who intentionally traffic in components.

And by that, I mean certificates of authenticity, manuals, end-user license agreements. These are the components that go into a software package which essentially authenticate the software.

These people knowingly traffic in genuine components because they know, frankly, that they can't be arrested, they can't be prosecuted for that. There is a brisk million-dollar business around the world in the trafficking of these components. As a matter of fact, we have noticed that we have experienced a sharp increase in the number of thefts of these components around the world.

For example, a simple certificate of authenticity will sell for approximately \$50 on the market. We had a theft in California a couple of years ago of 80,000 certificates out of a facility. These people are trafficking in these components because they know nothing will happen to them. They are selling them to people who combine them with counterfeit software and then sell that either over the Internet or through their distribution channels.

Mr. SMITH. Okay. Mr. Malcolm, are laws sufficient, or do we need additional laws to help you prosecute these individuals?

Mr. MALCOLM. Well, Mr. Chairman, we are—as you can imagine, we have ongoing dialogue with Microsoft on all manner of issues, and we have certainly discussed this matter with Microsoft. We have an open door.

We are exploring with them the scope of this problem and looking to Microsoft to provide us with some specific examples of cases where the laws are inadequate. We're in the process of having those discussions and evaluating the issue, and we're not recommending anything one way or the other at this stage. However, we remain open to being persuaded that there are loopholes that need redressing by Congress.

Mr. SMITH. Okay. Thank you, Mr. Malcolm.

My time is up, Ms. Vidov. But I have a hunch Mr. Berman is going to cover the subjects that I wanted to ask you about as well.

So, Mr. Berman, the gentleman from California, is recognized for his questions.

Mr. BERMAN. Well, thank you very much, Mr. Chairman.

Well, first, Mr. Valenti, you introduced the director of "Bend It Like Beckham" and who I had the chance to meet yesterday. A very interesting story of the impacts of piracy, particularly on college campuses in the context of an independent producer who is—ability to get the financing for her next film will very much depend on the efficacy of interest in this movie. And so, again, a different face.

But her story regarding the piracy and the college campuses reminds me of the hearing that the Chairman called 2 weeks ago on peer-to-peer systems, and there the context was mostly about music.

But I know you've been going to college campuses recently, went to Duke and, I think, either to George Washington or Georgetown just recently to talk about this. In terms of independent films and film-making, not music, I'm curious the students' reaction and just your sense of how they're reacting to the message that you're delivering to them.



Mr. VALENTI. Matter of fact, I was at all of those universities, and Tuesday, I was at Stanford. And I'm on a little crusade, and I do have personal interaction with these students after I speak.

What I have been trying to tell them is that no free nation can lay claim to greatness unless it's constructed a platform from which springs, I think, a moral compact. Which I think in a speech I delivered at Duke I laid out, saying this is all part of what William Faulkner called the old verities—duty, service, honor, integrity, pity, pride, compassion, sacrifice.

And I said to these students, if you treat these words casually, if you think that only the rubes and the rabble and the unlearned and the unsophisticated are the only ones who honor and observe them, then you're going to witness the slow undoing of the great secret of America.

Now, none of these kids would go into a Blockbuster store and walk out with a furtive glance with a DVD under their jacket. They wouldn't do that because they know they would get caught, and disciplinary action will come—humiliation and embarrassment, besides being a crime.

Yet these same students will go on the Internet at file-swapping sites and put a DVD in their digital jacket with total impunity and feeling guiltless. They have—I told them they're practicing a kind of sophistry in which they are trying to say, well, maybe it's a kind of stealing, but everybody else does it, and besides, music and movies cost too much.

There is a sense of decay there, but the good news is that I found that there is a silent majority operating on campuses. The students come up to me after I have these one-on-one open forums, and they'll say, "Well, I didn't speak up, Mr. Valenti, but I couldn't agree with you more. We know it's wrong. We know it's a crime, and we ought not do it."

And I believe that as universities begin to organize and construct codes of conduct, where the students understand with great clarity what the rules of the game are—that you get caught one time, maybe you get a slap on the wrist. The second time, some schools are taking away your computer privileges. Third time, you may be subject to disciplinary action.

I think once those codes of conduct are in place so everybody understands what the problems are and make this a high-risk, not high-reward kind of an enterprise, then I think these young kids are going to understand that it is not only morally wrong, they're stealing.

Mr. BERMAN. Thank you.

Ms. Vidov, the—you mentioned your horror story and what the conduct of the Russian ministry and their allies have done to your investment and your legal rights. You mentioned another case.

But how widespread, from your investigation and work on this, do you think this problem is, and from that, do you draw any—do you have any conclusions regarding the Russian investment environment and how the U.S. should handle its Russian trade relations as we deal with growing Russian interest in joining WTO?

Ms. VIDOV. I think that the big companies are quite different from the small and medium enterprises. And I think that the small and medium enterprises are sitting ducks if they invest in Russia.

If they haven't already come under attack, then it could happen to them any day.

There are about 25 small and medium businesses on the ambassador's short list of what as far as I can tell as a former investigative reporter, I don't think there were more than 50 small businesses that ever invested in Russia. And each and every one of them have pretty much the same story that we're telling.

We happen to be in intellectual property, but you're going to hear the same story from the guy who cashed out his pension to open a sport salmon fishing retreat on the Kola River, or Gary's company, you know, which invested \$8 million in a plant in the middle of Russia that—I hope I don't get it wrong—grows artificial quartz, to a company that invested in grain silos in the Far East.

In every single case, it's the same. And I don't know what can be done to stop the Russians other than make it clear to the Russians that we're not going to send investors in if the situation doesn't improve.

We've gotten to the point where I mean virtually everyone, large and small, who invested in Russia, their lawyers said to them, oh, you know, Russia's a signatory to the UN Convention on Enforcement of Foreign Arbitration Awards. So everyone put in, oh, you can arbitrate in Sweden, or we're going to arbitrate in London.

The only problem is when the American companies go, and for the small ones it's considerable expense, and win those cases, they can't get them enforced. It doesn't matter that Russia's a signatory.

The man I told you about from the Kola River project, the salmon fishing? He actually got a decision from the Russian supreme court that said because we're signatories to this convention, we have to enforce. And now, they've taken him to court 80 times to avoid paying him.

Mr. SMITH. Thank you, Mr. Berman.

The gentleman from Virginia, Mr. Goodlatte, is recognized for his questions.

Mr. GOODLATTE. Thank you, Mr. Chairman. I very much appreciate your holding this hearing on an issue that, as you know, you and I have both been involved in promoting for several years now.

Mr. Valenti, I want to commend you for how you have helped the Members of this Committee and others visualize the true extent of this problem. This is not just a matter of somebody making a few copies in their basement and going out on a street corner and selling it.

This is a big, big industry, and it is linked to other aspects of organized crime and to other misuses of funds, including terrorist activities. And it's a multi-billion dollar industry, and we've seen it all around the world.

Chairman Smith and I were in Moscow a year ago, the charge—you'll be interested in this, Mr. LaMagna. The charge at the U.S. embassy, the second in charge, came over to our hotel to brief us. He stopped a block from the hotel on his way in and bought a copy of the business version of Microsoft Windows, which costs hundreds of dollars in the U.S., for \$2.70.

And I still have that copy, by the way. If you'd like it, I'll be happy to surrender it. [Laughter.]

Mr. GOODLATTE. It's not usable on any system that I know of. It is nonetheless an example of the nature of this problem, which is huge.

It's not just in other countries. There was a huge raid on Canal Street in New York City last year, where millions and millions of dollars of counterfeit goods were seized. And all those little stalls there in New York City are not just little independent operations either.

The report showed that the underground area around Canal Street was honeycombed with storage facilities and hideouts and so on for this very sophisticated operation, which has the face of a little guy with a little operation.

I was in Spain, in Madrid, a few weeks ago. On the sidewalks all over Madrid are little blankets with maybe a hundred DVDs or CDs. When they see somebody coming, they can grab that blanket, wrap it up, and be running down the street in an instant. But there are millions of them all over the city. So the problem is truly astonishing.

Now, one thing I want to say to Jack Valenti is that I think a lot of these countries are getting it—not only from the standpoint of their obligation to combat this kind of piracy, this kind of crime in their country, but also from the standpoint that this really hinders their ability to be able to develop intellectual property in their country.

The Russians, in particular, a wonderful country of tremendous scientific and creative abilities of many of their people, but there's no way to develop a significant software industry or creative arts industry. If they do not protect our intellectual property rights in their country, they're certainly not going to also be able to develop their own legitimate business where people can be rewarded for their creativity.

So my question to you, Mr. Malcolm, is what kind of efforts does the Justice Department have in coordinating these efforts around the world? And do you have a project to try to get countries to pass legislation? I know the Russian Duma, for example, is meeting today, as we speak, on this very issue.

What kind of coordinating efforts does the Justice Department have to not only encourage the enforcement of the law, but the encouragement of the adoption of this ethic by passing laws creating greater protections for our intellectual property and their own in countries around the world?

Mr. MALCOLM. Certainly, Congressman. Obviously, beyond the Justice Department, State, USTR and PTO are all involved in this effort as well, since it's a diplomatic effort in addition to a law enforcement effort.

On the law enforcement front, CCIPS, and other representatives of the Justice Department are actively involved with law enforcement all around the world, and with respect to Operation Buccaneer, for instance, we have had effective coordination with the Australians, the British, the Swedes and the Finns.

Last year, representatives from CCIPS met with over 30 representatives from nations around the world in various face-to-face meetings here and abroad to discuss legislative efforts, law enforcement training and different techniques in how we would be able to

work well together. There are even more trips planned for this year, including, for instance, this summer a 2-week training and discussion session scheduled for China, where you know this is a particular problem.

So we're actively involved in engaging in 24–7 contacts with our counterparts around the world in stressing the need for effective IP enforcement.

Mr. VALENTI. Mr. Chairman, may I amplify what Mr. Goodlatte—

Mr. SMITH. Yes, I'm sure he'd be happy for you to do that.

Mr. VALENTI. I think, Congressman Goodlatte, you really hit something when you're talking about your visits or your importing foreign countries.

I think codels in their visits around the world can be a superior method of striking a real chord with these foreign countries. And I know that Congressman Wexler, Chairman of the Congressional Taiwan Caucus, has been singularly effective in meeting face-to-face with Taiwanese and telling them what is right and what is wrong.

I know that other codels have gone all over the world, and we know about it to try to work with them and brief them. But I suggest, Mr. Chairman, that's one of the great instruments in favor of doing something worthy in this field, and that is the codel itself. It has a marked influence on these foreign officials.

Mr. SMITH. Okay. Thank you, Mr. Goodlatte.

Mr. GOODLATTE. Mr. Chairman, if I might, I have an opening statement I'd like to submit for the record.

Mr. SMITH. Okay. Without objection, that complete opening statement would be made a part of the record.

[The prepared statement of Mr. Goodlatte follows in the Appendix]

Mr. GOODLATTE. Thank you, Mr. Chairman.

Mr. SMITH. Thank you, Mr. Valenti, for your good point. We'll take more codels with that in mind. [Laughter.]

Mr. SMITH. The gentleman from Massachusetts, Mr. Meehan, is recognized for his questions.

Mr. MEEHAN. Thank you, Mr. Chairman. I, too, would like to submit my opening statement for the record.

Mr. Valenti, I keep hearing that the entertainment industry is suffering greatly as a result of digital piracy. However, in 2002, Hollywood obviously set a box office record with movie theaters selling over \$1.5 billion in tickets, \$9.5 billion worth of revenue.

This may seem to some people to be contradictory, and I was wondering if you could clarify that issue.

Mr. VALENTI. I mentioned earlier on a similar question, Mr. Congressman, that only 2 out of 10 movies ever get their money back from theatrical exhibition. It is mandatory to retrieve their investment to move through the other venues—HBO, premium cable, airlines, hotels, basic cable, network, and international. We have to do that.

And if this movie is stolen early in the journey of that movie to all of these other venues, it, without any question, decreases the value of that movie. Now, remember, in America, unlike most coun-

tries, all movies are made with private risk capital. Either you borrow money from a bank or you get investors to put money in it.

And if down the road in '04, '05, and '06, it begins to look like that we're in a state of decay, some of that private risk capital is going to go other investment opportunities. So it is very important for us to begin now to stop this before it becomes a flood tide.

Mr. MEEHAN. It's my opinion that publicizing the individuals caught engaging in copyright infringement of any kind is—can be a great deterrence. What is the industry doing along these lines?

In other words, are you working in conjunction with Government agencies in this process? Do you see for a need to reform in this area? And if so, what would you propose?

Mr. VALENTI. I think in the area of analog piracy and DVD counterfeiting—I'm not talking Internet piracy now—the Justice Department has been marvelously cooperative. The FBI has lifted the level of importance of intellectual property theft to its large priority. U.S. attorneys are on the alert.

Of course, now with terrorism on the rise, a lot of the resources of the FBI and U.S. attorneys are being directed other places. But I cannot tell you how grateful I am for what the Justice Department, other agencies are doing.

Our problems in this area are largely foreign. And for example, in Australia recently, just last March, a big raid found 35,000 counterfeit DVDs brought in by two Malaysian nationals. They arrested them, tried them, sentenced them. A very light sentence and a fine.

And guess what? They deported them. They never served any time in jail, and they never paid their fine. So the Malaysians probably say, "Hey, this is a terrific business we're in. Let's do it again." And that sort of thing is endemic and pandemic around the world.

Mr. MEEHAN. Ms. Borsten, you highlighted in your testimony in great detail your company's particular experience with the Russian government. Do you believe that your experience is unique, or do you feel that there is a general problem that exists for the United States companies trying to protect their property rights in Russia?

Ms. VIDOV. Well, as I said in a previous question, I just don't think Russia is ready for American investment. It's certainly not ready for small and medium companies, and as you know, they're the backbone of our country, and they're going to have to be the economic backbone of Russia if it's going to become a viable market economy.

And they—the Russians, I mean, they need to understand—the same thing happens every time. If you're successful—and that's the key. It's not that as a small, medium company, you go in and you take the normal risks. But then the problem in Russia is you become a success and you're targeted by some government minister or governor who says, "Gee, you know, I want that for myself."

And they manipulate the courts to get it from you, but they don't take what you establish—what they do—and continue it. Instead, they divide it up, and they sell off the assets and pocket it. So the people that you created jobs for, now they're out of work. The revenue streams that you created that were coming into Russia, they're gone.

So a lot of work needs to be done, and the Russians need to be—we shouldn't be—we shouldn't be out there cheerleading and saying, you know, go to Russia, is my opinion, and invest because an investor has not very good chance to actually see the results of his investment.

Mr. MEEHAN. And it's interesting because we've tried to put a lot of attention into helping them set up a judicial system, helping them set up some kind of a financial system. But it sounds to me that you have drawn general conclusions about Russian investment, the environment.

And are there any conclusions between the United States-Russia trade relations from your perspective that you would draw here?

Ms. VIDOVA. I think—I know that there are budget cuts. But I think that as much money as possible has to be put into rule of law aid that we can give them and, you know, sending judges over and sending delegations. And I mean, I think that the people themselves want to do the right thing.

And really, one of the things that happened in our case was that the reason that we know as much as we do about all of these ex parte meetings is that there were people in the involved ministries who were outraged at what happened and came and delivered to us the documents because they knew that it was wrong.

So I think a lot of Russians want it to be that way. But somehow, it's just not happening.

Mr. MEEHAN. Yes, we're sending a lot of people over there, but maybe we just need to do a better job or send more and maybe have it more structured.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Meehan follows in the Appendix]

Mr. SMITH. Thank you, Mr. Meehan.

The gentleman from Virginia, Mr. Forbes, is recognized for his questions.

Mr. FORBES. Thank you, Mr. Chairman. And thank all of you for being here today.

Certainly, I think that we're all very concerned about this. One of the big problems is that we're losing a lot of money that we could be utilizing in other places. Secondly, a lot of the money is going to the wrong people and used for wrong purposes.

But I think one of the things that's useful is just this education process and getting these statistics out. Unfortunately, I don't think a lot of people see the correlation between some of the piracy issues and some of the things that are taking place.

One of the things that hit me is that we see the television ads by the Office of National Drug Control Policy, where all those ads convey a message that, you know, every time this action takes place, look at who you're really helping. And it would be good if we could see some of those ads along this line, too, because I think a lot of our public doesn't really realize it.

The second thing, I think it's important that we begin to perhaps look at some of these issues and some of our trade agreements and perhaps how we're enforcing those trade agreements. I think that could be a significant help for us.

The final thing, though, that I have a question about. Mr. Valenti, you talked about the 40 percent figure for our motion pic-

tures and that we needed to make another 40 percent in other venues other than theatrical exhibitions—for example, internationally.

What percentage of that statistic is made up internationally? Do you have a feel for that?

Mr. VALENTI. Of the total revenues to the American film industry, Mr. Forbes, around 40 percent of those total revenues in movies, television, home video, pay-per-view come from international markets.

Mr. FORBES. Oh, so about 40 percent is international markets.

Mr. VALENTI. And 60 percent domestic.

Mr. FORBES. Of that 40 percent, we talked about the codels, which I think certainly are always good opportunities. Is there any dialogue that goes on between the motion picture industry and some of the foreign countries in terms of wanting to get their support for enforcement of some of these laws and provisions there?

Mr. VALENTI. Yes, Mr. Forbes. As a matter of fact, the Motion Picture Association is a global enterprise. We have offices in Brussels and in New Delhi and in Rio and Toronto. We have offices in Singapore and Beijing. So every day, we are at work moving around the world, talking and meeting with officials.

I myself spend a good deal of my time on airplanes going to Europe, Latin America, Asia, and meeting with foreign ministers, prime ministers, ministers of culture, et cetera, trying to persuade them that it is in their long-term interest that they do things to curtail piracy.

Indeed, one of the things that's drawing together in a seamless web of unity are the creative communities of the world, usually antagonistic to us because that we have so much of the marketplace. But now they're with us, joined at hip and thigh, because they realize that pirates, criminal pirates are equal opportunity thieves. They steal everything that they believe has a marketplace.

And therefore, we're finding a great deal of support from the actors, writers, directors, producers—the people who do films in these foreign countries, which is very helpful.

Mr. FORBES. And we talked about the Russian problem, obviously, that exists there. But this 40 percent figure that we're looking at, can you give us a basic idea of where you tend to see your biggest losses internationally in this area?

Mr. VALENTI. Yes. The biggest losses are in Russia, China, Malaysia, Thailand, and other places like that. Russia is totally out of control at this time. I think your comments were absolutely authenticated by what we find over there.

As a matter of fact, I am at this moment in contact with our ambassador in Russia and with the Russian officials. I believe that I'm going to have an appointment sometime in late April, early May with the Russian prime minister that Mr. Putin, the president, has put in charge of this piracy situation. And I intend to confront him and talk about this.

He's agreed to the appointment. So I would assume they would have some kind of rebuttal to the grievances that I will put before him.

Mr. FORBES. And it's always good to look at the areas that we have a concern like Russia. But where would you say would be the

best models that we could look at as far as countries that have been supportive of the motion picture industry perhaps or basically protection against these kind of issues?

Mr. VALENTI. Mostly in Western Europe. I think they do a very good job. Their laws are pretty sturdy, and there is—but you can have a great copyright law, Mr. Forbes, that's just absolutely exquisite in all of the things that we want to do, but there has to be a political will, a political resolve to enforce those laws.

And unhappily, some countries' officials of the government are involved in the piracy operations, which does make it a little bit difficult for them then to enforce the copyright laws.

We have some problems in Brazil at this time. We hope to alleviate our problems in Mexico. I think President Fox has been very forthright in trying to help us on this and his attorney general as well. We're making some progress there.

But it is in Asia is where most of this is going on, and I include Russia there. As I said, Russia is making this a great export business. They do about 300 million, maybe, DVD counterfeit copies. They only consume about 18 million of them in Russia.

So what do you do with the other 200-plus million? You export it. It's part of your export trade.

Mr. LAMAGNA. Mr. Chairman, may I comment on that, please?

Mr. SMITH. Even though the gentleman from Virginia's time has expired, yes, please go on and comment.

Mr. LAMAGNA. I'd just briefly like to say that we do have some models in the Federal Government and a history.

My background is drug enforcement for 28 years, DEA and FBI. And I saw where we, over the years, have built the capability, the institution building, international agreements to get governments to adopt regimes for enforcement, the 1988 Vienna convention on drugs.

And I think we have—we have some models here for training, for information sharing, for cooperation, for free trade incentives. And I see parallels between the drug industry and organized crime and the pirating in software. And I think we could look back on those models to see what we've done because they've been very, very successful over the years in certain countries.

Mr. SMITH. Okay. Thank you, Mr. Forbes.

The gentleman from Florida and Chairman of the Taiwan Caucus, Mr. Wexler, is recognized for his questions. [Laughter.]

Mr. WEXLER. Thank you very much, Mr. Chairman. And I, too, want to thank you for calling this hearing to highlight the extraordinary connections, disastrous connections between international copyright infringement and organized crime.

I can't help but sit here and wonder, and I'm sure most Members of this Committee and people involved in this community have had these discussions with many parents who don't yet fully understand the ramifications of what it is to steal a movie or to pirate a song.

If more American parents understood the connection between the pirating of intellectual property and organized crime, I think there would be a much more effective public relations response in our own country to better appreciate the disastrous ramifications of what is occurring.



And I think Mr. Forbes, very rightfully so, brought up the commercial with respect to drugs, whereas I think most Americans at this point appreciate the connection between the purchase of an illegal drug and organized crime and the profits related thereto.

If most Americans understood the facts as Mr. Valenti presented them this morning that the profits from the stealing and pirating of intellectual property are greater than the profits to organized crime of the illicit sale of drugs, I think there would be an incredibly more effective response even within our own country.

And having watched Mr. Valenti's presentation, in some degree of jest, I wonder whether the Motion Picture Association would turn its attention toward Iraq, and we probably could find the mobile chemical weapon laboratories if your intelligence seems as good as it appears to be this morning.

I would like to address two questions to Mr. Malcolm, if I could. And I say this with the preface that your presentation this morning I think is an exceptionally detailed commitment by the Department of Justice in outlining what the problem is.

But what I would like to inquire is, understanding what the problem is, what is the level of the intensity in terms of the action of the Department of Justice in responding to the problem that is at hand?

So I would respectfully ask could you elaborate on what the Department of Justice's role is, in your view, and will be in terms of actually combating the actual piracy abroad? What programs are in place that will focus the attention of the Department of Justice on the piracy abroad?

And it would seem to me that while this goes beyond the Department of Justice, that there needs to be a concerted effort, not just by the Department of Justice, but by the Commerce Department, by the trade representative to the point where any American official, whether it be a Member of Congress or potentially even more important, a member of the executive branch, when they meet with officials of those offending countries that this issue be highlighted to the point where all of the tools of American commercial interests and other interests will be tied to the issue of piracy.

So I would ask if you could elaborate on what actually the Department of Justice is doing. And in that same light, in talking to some of our own officials here at home, I think a number of us last fall wrote a letter asking what was the effort that was being conducted with respect to the preparation of prosecutors in our own country to better understand how to prosecute peer-to-peer piracy?

As I understand it, that's not something that most lawyers learn in law school. And if you could define for us either here today or in writing, if that's more appropriate, what is occurring in the Department of Justice to better prepare prosecutors to actually be in a position to prosecute?

Mr. MALCOLM. Congressman, thank you for that question. With respect to your side comment about the need for our trade representatives and Commerce Department to be actively involved in this effort, I applaud that statement and agree with it.

With respect to what the Department of Justice is doing, let me say that in the year and a half that I've been in this job, and I was

a Federal prosecutor in Atlanta for 7 years, so I'm familiar with the prosecutorial process, this has been a personal priority with me.

I've had an open door, for instance, with the MPAA. I've met with Mr. Valenti. I've met with representatives of the RIAA and the intellectual property community.

We have established 13, as I stated, CHIP units, which are growing. Which have prosecutors who are dedicated to computer crimes, a significant portion of those resources are devoted to IP crimes.

The Computer Crime and Intellectual Property Section has roughly doubled, with the assistance of Congress through the resources that were given, since the time that I have been there, and they are using some of those resources to engage in extensive training, both here and abroad.

Every U.S. Attorneys Office has a Computer and Telecommunications coordinator, or CTC. I should say every office has at least one, in many cases two or three. This is a huge problem. It is a global problem.

Through some of the activities that I've talked about, such as Operation Buccaneer—there are others, Operation Bandwidth, Digital Piratez—we are trying to cut off the heads of some very large snakes that are involved in putting out this material to be pirated and to cost our economy and to raise huge dollars for nefarious people.

That having been said, there are a lot of snakes out there, including some big ones that we still have to tackle. However, despite the resource crunch from the war on terrorism, at least at the Department of Justice as it comes to intellectual property crime, we have had an unprecedented level of increase in activity during the past year and a half that I've been there.

Mr. SMITH. Good question. Thank you, Mr. Wexler.

My colleague from Texas, Mr. Carter, is recognized for his questions.

Mr. CARTER. Mr. Malcolm, tell me what's the—on the peer-to-peer problem that we have, under what statutes would you prosecute someone peer-to-peer, and what kind of punishment range would that carry with it, should there be a conviction?

Mr. MALCOLM. Thank you, Representative Carter. I'm sorry that I had forgotten to mention peer-to-peer in response to Mr. Wexler's question. Let me be clear with respect to peer-to-peer what it is that we are talking about.

There are the operators and designers of peer-to-peer networks, and there are those who use peer-to-peer networks for the purposes of copyright infringement. And I want to distinguish between the two because one thing the department is very sensitive to is to the notion of not wanting to stifle technology and its developments on the Internet.

Peer-to-peer, any type of a system can be used for good purposes or nefarious purposes. It can be used to transmit noncopyrighted material for academic research, personal, you know, fair use, what have you. It can, of course, be used and is being used for rampant infringement.

So with respect to the people who design and operate peer-to-peer networks, we remain open to evaluating evidence that is pre-

sented to us that it is being designed for the purpose of facilitating copyright infringement and we'd consider an appropriate case.

With respect to those people who use peer-to-peer networks or, for that matter, any other mechanism to engage in copyright infringement, we will prosecute them. We can prosecute them under the criminal copyright laws, which generally carry up to 5 years. Felonies, we can prosecute them under the net act, which is a 3-year felony. They have different elements that are involved, and one would need to evaluate based on the specific facts of the case presented.

Mr. CARTER. Just starting there, I've been in the punishment business now for about 20 years. I happen to feel punishment is a deterrence to crime. I think when we publicize in the drug industry that we're busting users and we're busting mules and we're busting pushers that it slows down the traffic in drugs.

And I think that it would be a good idea to go out and actually bust a couple of these college kids. And you know, if you want to see college kids duck and run, you let them read in the paper that somebody got about a 33-month sentence in the Federal penitentiary for downloading copyrighted material, and I think we might slow at least that traffic down quite a bit.

The other thing I'm curious about is on this international piracy, you know, we're hearing about it here. But you don't read about it in the newspaper. It's not publicized. Are you getting convictions in that area, and are the sentences appropriate?

Mr. MALCOLM. Congressman, with respect to international piracy, it does get some press. In certain cases, for instance, Operation Buccaneer, which has been an international effort, I believe has gotten a fair amount of press. As I said earlier with Mr. Griffiths's indictment and our seeking extradition of him from Australia, that was just announced yesterday. It's my understanding that that's been reported in the media.

And if I may just briefly comment on your comment about university settings and publicizing what it is that we do. One is that I agree that universities should not somehow be off limits, and the people who use those systems to engage in copyright infringement. With respect to Operation Buccaneer, for instance, seven universities were searched in connection with that operation. And the systems administrator, for instance, at MIT for the economics department was targeted and convicted.

With respect to advertising our efforts, I would note attached to my written testimony is a Web page. In connection with the Digital Millennium Copyright Act plea recently, an individual named David Rocci surrendered his Web page called ISONEWS.com. It was very popular in the warez community.

We took it over, published a deterrence message. And within 2 weeks, there were over 550,000 hits. So that's people who would otherwise be interested in piracy who will see that site and will have a very clear message as to the consequences of engaging in that activity.

Mr. CARTER. Thank you.

Mr. Valenti, nobody that I know of in the entire world communicates with the American people and the people of the entire

world better than the motion picture industry. And I probably learned—and I've been a trial judge for 20 years.

And I probably learned more about the international drug industry from the movie "Traffic" than anybody else. And I think the whole country did.

Why don't you all start making movies about this is international crime? You know, this would be a subject of a lot of good movies, and actually people would start realizing when they're stealing these things that they're participating in international crime.

Mr. VALENTI. Well, first, Judge, I want you to know anybody that comes from Texas can't be all bad. I want you to know that. [Laughter.]

Mr. VALENTI. So, secondly, do you have an agent, by the way? [Laughter.]

Mr. VALENTI. Because before we talk about this, I think that's a darned good idea. Frankly, I hadn't thought about it. That's something we ought to do. But as a matter of fact, I am going to suggest that to some of my writer friends out in Hollywood.

One of the things you said, though, captured my interest about how to deal with this university piracy. My lawyer who is here, Troy Dow, went on KaZaA, which is one of these notorious file-swapping sites. And at the bottom of the screen on KaZaA, they tell you with great candor how many people are on KaZaA at that precise moment, how many files they are invading, and how many bits of information they're trading.

Last week, when he went on KaZaA, there were 4.19 million people on KaZaA at that precise moment. They were trading 550 million files—550 million files—with 5 quadrillion bits of information. A quadrillion is one million billion, which is too many zeroes for me to contemplate. But that's the kind of activity 24 hours a day.

The reason why—I think one reason why the university is taking a serious interest in codes of conduct, they're having to spend millions of dollars in increasing the bandwidth of their state-of-the-art, large pipe, high-velocity broadband networks. It's sagging under the weight of all these student activities.

Now, they're not going up there to do a paper on Nietzsche or Herodotus. They're going up there to trade files mainly in movies. And as a result, the universities are having to do something about it.

One story to show you how bad this is. I'm not going to name the university. It's one of the most prestigious universities in this country. Last year, their broadband access system was so bombarded with student activity, particularly in a file-swapping site called Gnutella, they actually set up a separate server for Gnutella so that anybody who wanted to go on Gnutella would not go on the university system, they'd go to this special server.

And the campus daily that one of my people, Rich Taylor, who's here, found it on the Internet. The campus daily has an editorial, Mr. Chairman, Mr. Carter. It said, "We certainly thank the university for this new file server. It's going to make it a lot faster and easier for us to upload and download."

The next paragraph says, "However, the university has a conundrum here in the way of a moral issue here because they're saying it's okay for us to take something that doesn't belong to us."

Well, I fired off a fiery letter to the president of that university. You know the idea. A letter that says "harsh words to follow," that sort of thing. [Laughter.]

Mr. VALENTI. And within 10 days, they took the server down. But that's what's going on because these universities are being overburdened with this kind of activity. And one of the problems is, as you point out and we all know, it's low risk. Nobody does anything about it.

Mr. CARTER. That's right. And one final question, if I may, Mr. Chairman.

Mr. SMITH. The gentleman is recognized for another question.

Mr. CARTER. Mr. Valenti, you talked about the other countries that help in enforcement. What—if you were going to say the three best countries that help with enforcing these laws overseas, where would they be? What would they be?

Mr. VALENTI. Our anti-piracy experts, and we do have an anti-piracy division that operates in over 41 countries in the world. Lately, Macau, Hong Kong are two places where we're getting pretty good help. I think that Mr. Malcolm may confirm some of that.

I think the UK is very good because they are putting big sentences. They busted one notorious pirate and gave him, I think, about 10 to 15 years in the slammer, which does tend to make your eyes smart a little bit and makes you think you might want to go in another business.

I think those are the—the European Union has just passed a copyright directive, which we think is pretty good. They have an enforcement directive that now is trying to be implemented. So I think they're trying to do what they can to make sure that they can try to find a way to conquer this, this terrible thing.

Mr. CARTER. Thank you.

Mr. SMITH. Thank you, Mr. Carter. And thank you all for your testimony today.

It seems to me that we've had a nice confluence of enlightening testimony, perceptive questioning from many Members, and instructive answers as well, all of which is going to help this Subcommittee.

It also seems to me quite obvious that the problem is growing worse, and we are not doing enough to reduce the problem. And I'm not sure enforcement alone will do it. It's going to take the cooperation of foreign governments, some of which may or may not be inclined to help us. We've heard specifically about Russia.

But in any case, we're going to have to do a lot more, whether it's intergovernment treaties or cooperation or leverage or whether it's enforcement on our side by the DOJ or others. Regardless, it's a problem that should not be overlooked and needs to be addressed.

And I just realized that we on this Committee, I think, are pretty much unanimous in wanting to stop that problem from becoming worse and, in fact, try to reduce the problem and reduce the impact on real people. Now that's something that oftentimes goes overlooked.

We talk in sort of thematic general, almost idealistic terms about organizations and so forth. But we're really talking about real people, whether it be musicians or artists or actors or recorders, anybody else. It is those individuals who are being hurt. It's their live-

lihoods that are being lost, and we certainly want to address that in the future.

So I thank you again for being here today and thank you again for your testimony. We'll no doubt see you again at some point in the future.

[Whereupon, at 10:39 a.m., the Subcommittee was adjourned.]

## APPENDIX

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### STATEMENTS SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE HOWARD L. BERMAN, A REPRESENTATIVE  
IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Chairman,

I commend you for putting together another fine hearing.

I want to particularly thank you for inviting Joan Borsten to testify. Joan is a constituent and a good friend from way back. She brings a valuable perspective to this hearing: that of an American entrepreneur whose business has been dramatically impacted by a foreign government's sustained campaign to steal her rights to intellectual property. Because we usually hear about copyright piracy from large corporations or wealthy celebrities, we often lose sight of the impact that piracy has on individual American entrepreneurs or copyright owners.

While international hard-goods piracy may seem a dull subject to some, it is a critical issue to U.S. copyright holders. The aggregate hard-good piracy losses suffered by U.S. copyright industries in foreign nations are pretty astounding. According to the International Intellectual Property Alliance, or IIPA, "losses due to piracy of U.S. copyrighted materials around the world are estimated to reach \$20–\$22 billion annually (not including internet piracy.)"

Even more astounding are the piracy numbers for individual foreign nations. In 2002, the U.S. motion picture, recording, music, software, and book publishing industries collectively suffered piracy losses of \$1.85 billion in China; \$800 million in Italy; \$771 million in Brazil; \$757 million in Taiwan; and \$756 million in the Russian Federation.

The percentage of pirated goods in these five nations provides another disturbing measure of the severity of the problem. In 2002, 93% of business software sold in China, 47% of music sold in Taiwan, and 80% of movies sold in the Russian Federation were pirated. In 2001, 99% of entertainment software sold in Brazil was pirated; while in 2002, 55% of entertainment software sold in Italy was pirated.

As piracy percentages climb in a particular nation, it becomes increasingly difficult for U.S. copyright owners to establish a legitimate market. In some cases, as with entertainment software in Brazil, U.S. copyright owners have had to abandon the market entirely. U.S. copyright owners simply cannot justify the expense of maintaining a presence in a nation where the demand for their copyrighted works is almost entirely met by vastly cheaper, pirated versions.

The piracy-related inability of U.S. copyright owners to access a legitimate market in many foreign countries results in real harm to the U.S. economy. The core copyright industries make a tremendous contribution to the U.S. economy—accounting for more than 5% of U.S. GDP, 3.5% of total U.S. employment, and \$89 billion in foreign sales and exports in 2001. How much greater would their contributions to the U.S. economy be if U.S. copyright owners could access foreign markets otherwise dominated by pirate product?

Rich LaMagna of Microsoft will, I understand, try to answer this question with some real numbers. I don't want to steal his thunder, but I cannot help remarking on his estimate that in 2008 software piracy will cost the U.S. \$1.6 billion in lost tax revenue. While \$1.6 billion may only be a small portion of the federal budget deficit currently forecast for 2008, it nonetheless represents significant revenue that could fund critical government priorities.

I realize these numbers and percentages are dry, and their sheer size sometimes begs skepticism. That is why Joan's presence here is so important.

Joan's personal story of intellectual property theft by the Russian government provides a context to these numbers, just as she provides a face for U.S. victims of international copyright piracy. While I don't want to steal Joan's thunder either, I

do want to highlight some of the issues that I think her particular situation presents.

In Joan's case, the thief of her intellectual property rights is not some private syndicate operating in distant shadows within a foreign nation, but is a foreign government itself—the Russian Federation government. Through the establishment of dummy corporations, fraudulent license transfers, and illegal pressuring of Russian courts, the Russian Federation government has attempted to deprive Joan of her valid license to copyrights for a library of Soviet-era animation.

Where a foreign government is itself stealing intellectual property from a U.S. citizen, it is particularly appropriate for the U.S. government to demand that the foreign government stop the theft. Conversely, it would be entirely inappropriate for the U.S. to grant any special trade privileges, such as WTO accession or GSP benefits, to a foreign nation whose government is stealing intellectual property from a U.S. citizen.

Mr. Chairman, I know your particular focus today is on the links between organized crime, terrorism, and international copyright piracy. In that regard, I wish to note that intellectual property theft by a government represents the very essence of organized crime. In any nation, there is typically no bigger organization than its government, and no greater power. Thus, when the government steals intellectual property, it is engaging in organized crime of the highest magnitude.

Thank you, Mr. Chairman, and I yield back the balance of my time.

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PREPARED STATEMENT OF THE HONORABLE BOB GOODLATTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. Chairman, thank you for holding this important oversight hearing on international copyright piracy.

I recently returned from leading a congressional delegation to Europe to engage in discussions about e-commerce and intellectual property with our European counterparts. While in Madrid, Spain, I was disturbed to witness blatant acts of copyright piracy—the latest movies and CDs openly displayed on blankets lining the public streets—sold for a mere fraction of the cost of the legitimate product. The criminals, engaged in the organized theft of copyrighted works, outnumber law enforcement and have a large network of “lookouts” prepared to thwart any law enforcement effort to stop them. The illegal activity that I witnessed in Spain is just one example in one country of the growing problem of organized theft of copyrighted works.

The effects of international copyright piracy are staggering. A recent report released by the International Intellectual Property Alliance states that last year alone U.S. companies suffered over \$9 billion in trade losses due to international copyright piracy. When you consider the fact that the U.S. copyright industry accounts for more than 5% of our gross domestic product, it is clear that international piracy is a serious problem that has devastating effects on our economy.

However, the effects of piracy are not limited to one country. Each nation in the international community must recognize that piracy is a global problem. The growth of piracy among organized crime rings is illustrative of its global scope.

The combination of enormous profits and practically nonexistent punishments by many foreign governments makes copyright piracy an attractive cash cow for organized crime syndicates. Often specializing in optical disc and business software piracy, these crime rings are capable of coordinating multi-million dollar efforts across national borders. For example, on December 19, 2001, Mexican officials raided numerous locations in Mexico in an effort to bust an organized crime ring there. These officials uncovered 12.5 million blank CD-R's and arrested eleven members, some of whom were armed with high powered weapons. Subsequent investigations revealed that the blank CD's were made in Taiwan, shipped to a shell company established in the U.S., and then shipped to Mexico, where the actual illegal copying and distribution occurred. We must meet this type of highly organized piracy with highly organized coordination and enforcement efforts.

Another disturbing trend is the growing willingness of many foreign governments to condone the use of, and even use, pirated materials. At its best, government sets the standards for the protection of rights. At its worst, government encourages and even participates in the breach of those rights. Now is the time for each country in the international community to choose which path it will take with regard to intellectual property rights.

We all must realize that copyright piracy is a serious problem that does not merely affect private companies' bottom lines in the short term. It also discourages investment and innovation in the long term, which will eventually lead to fewer con-



sumer choices—a repercussion that affects entire societies and economies. Governments must work together to reward creators and punish thieves.

Recent treaties, such as the TRIPS agreement, provide the legal framework for member countries to aggressively enforce their copyright laws. Article 61 of the TRIPS agreement specifically requires member countries to establish criminal procedures and penalties to be applied in cases of copyright piracy. We already have many tools to combat international piracy. Now we must put these tools to work. The United States must lead by example and rigorously enforce our copyright piracy statutes. However, we must also work with the international community to encourage other countries to do the same. Only when we coordinate our efforts to combat piracy will we see substantial results.

I look forward to hearing the testimony of our expert witnesses about the scope of the global piracy problem and learning about the steps that foreign governments are taking to educate their citizens and enforce their intellectual property laws.

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PREPARED STATEMENT OF THE HONORABLE MARTIN MEEHAN, A REPRESENTATIVE IN  
CONGRESS FROM THE STATE OF MASSACHUSETTS

International piracy is causing enormous economic damage to U.S. media and software companies, and these companies are understandably frustrated with the difficulty they have encountered in getting foreign countries to take piracy seriously.

In many parts of the world, officials are bribed to ignore the production and sale of massive quantities of pirated CDs and DVDs, and in others police do not have the resources to combat piracy or simply do not consider it to be a major issue.

As a member of the Armed Services Committee, I find it especially interesting that some of our closest allies—countries that depend on the U.S. to guarantee their security and receive large amounts of our economic and military assistance—do not seem to understand that protection of American intellectual property is a serious issue. I look forward to learning more about international intellectual property piracy and finding ways to combat the problem.

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PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE  
IN CONGRESS FROM THE STATE OF MICHIGAN

The piracy of copyrighted content is an overwhelming problem. While the content industries have created this country's number one export and have produced five percent of this country's Gross Domestic Product, we are being robbed of that economic value through the theft of movies, music, books, and software both here and abroad.

That is why we are at a crossroads in Congress and the executive branch. If we choose to strengthen enforcement of intellectual property rights, we can recapture that lost value. If we ignore the problem, we basically will encourage more piracy and the spread of organized crime.

Many criminal and terrorist enterprises make and sell pirated content as a way to make fast money. The International Intellectual Property Alliance, a coalition of copyright industry trade associations, has estimated piracy losses that are staggering for overseas piracy alone. In 2002, the movie industry lost approximately \$1.3 billion, the music industry lost \$2 billion, software companies lost \$3.5 billion, and video game manufacturers lost \$1.7 billion. If we are going to be serious about fighting criminal and terrorist enterprises, we must investigate and prosecute piracy.

And it is important to remember that piracy is not about lending a CD or DVD to a friend or using clips for a school project. It is about the theft of income from the very creators of that content: the screenwriter, the director, the actors, the engineers, the songwriter, the artist, the graphic designer, the writer, and so on.

I believe there are two related issues to address. One is whether governments abroad have the necessary laws to stop piracy in their home countries. The fact that we are having this hearing indicates that the Administration must do more to press for better intellectual property rights enforcement overseas.

The second is whether our own law enforcement agencies have the necessary authorities. With piracy increasing at a rapid rate, it seems clear that the FBI, the lead agency on these investigations, does not have the resources to conduct intellectual property enforcement. In fact, the FBI's own website notes that "domestic enforcement of IP laws has been inadequate and consequently the level of deterrence has been inadequate." It goes without saying that we must either give the FBI addi-

tional powers or give the authority to another agency that is better suited to the task.

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PREPARED STATEMENT OF THE HONORABLE ROBERT WEXLER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. Chairman:

I would first like to thank you, Mr. Chairman, for calling this hearing today to discuss the connections between international copyright infringement and organized crime.

The growing problem of copyright piracy has reached disturbingly high levels in many parts of the world from Thailand, Malaysia, and Taiwan to Russia and the former Soviet republics. And despite the obviously negative domestic and foreign effects of piracy and an international consensus against it, there are still a few remaining countries that are not treating piracy as a crime and even more that are turning a blind eye to this criminal activity. I have long been aware of the growing problem of piracy in Asia and Europe, two areas of the world where piracy is the worst. I find this assault on American business and innovation deeply troubling, and I am eager to hear testimony regarding what can be done to prevent this theft abroad.

At a time when American industry needs all the help it can get, international copyright piracy is crippling American businesses overseas. The cost of piracy just in Taiwan has serious international consequences. From an economic standpoint, piracy in Taiwan cost the U.S. copyright industries over \$333 million last year. The U.S. motion picture industry alone suffered \$35 million in piracy losses. Unfortunately, these loss estimates vastly understate the magnitude of the problem, since they fail to capture the dramatic impact of export piracy and the escalating losses due to Internet theft. While there is certainly much more that could be done to prevent this problem, at least Taiwanese officials publicly oppose piracy, recognizing that it is a problem in their country and a blemish on their foreign relationships. It is unfortunate that there are countries, Russia among them, with far worse records with copyright protection.

Even looking only at the consequences within the most egregiously offending countries, the impact of copyright infringement is enormous. Particularly as the growing connections between copyright infringement activities and organized crime become more apparent, the social impact for these countries is devastating. It is my understanding that in many areas of the world, organized criminal groups are heavily involved in—even spearheading—piracy and use the large sums of cash generated by this illicit business to increase their power and influence. Even more troubling is the fact that the criminal elements that oversee these illegal enterprises use young people in many of the low-level retail sales jobs, introducing these vulnerable youths into what may become a life of crime.

Given the far-reaching impact of these activities, it is clear that we must take strong action to end international piracy. We must encourage foreign governments to send a message that piracy cannot be ignored and is effectively condoned by the state. We must also encourage them to enact strong optical disc legislation and enforce existing domestic and international anti-piracy laws. Strong and ongoing enforcement is crucial to ending piracy and must include vigorous implementation and enforcement, shutting down all plants and owners of all plants that are found to be pirating, and a show of support for factories and owners who are found to be working in good faith. We must send an unequivocal message that the theft of American intellectual property—whether the corporate piracy of software, organized crime manufacturing of optical disks, or personal Internet downloading—will not be tolerated.

I want to thank the Deputy Assistant Attorney General and representatives from the entertainment and technology industries for being here today, and I look forward to hearing more regarding their experiences with combating this problem.

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PREPARED STATEMENT OF GARY R. JOHNSON

*Introduction*

I would like to thank Chairman Smith and other distinguished Members of the Committee for the opportunity to submit written testimony for today's hearing. The purpose of my submission is to call the attention of this committee to critical problems related to intellectual property encountered by Sawyer Research Products, Inc.

in an investment project in the Russian Federation. Other testimony today illuminates the problems encountered by entertainment and computer software industries in Russia. My testimony demonstrates that U.S. manufacturing enterprises face equally difficult, though very different challenges, as they conduct operations in Russia that require the use of their intellectual property in the form of proprietary technology.

At the outset, let me make clear that my testimony does not purport to make any linkage between piracy and organized crime or terrorism. Others more qualified in these areas may speak directly to those precise issues.

I come before you today as a businessman deprived of property and economic opportunity by the lack of rule of law in Russia. While today the Sawyer investment easily could be viewed as a failure, in fact our business was a success. Sawyer went into the heart of Russia and established a high-technology manufacturing operation in an idle and neglected former defense facility that, through our investment, began to export world-class products to several countries.

In contrast to many investors in the mid 1990s, Sawyer took a long-term view of its commitment to Russia. Indeed, more than ten years later, we persist. From the beginning we operated according to the highest ethical standards and with the utmost respect for Russian institutions. Moreover, we succeeded in creating an enterprise capable of becoming an important supplier of an essential material. I believe the Sawyer investment should be cited by Russia as a model for economic development utilizing foreign capital, marketing know-how, and technology to further the achievement of national goals. Instead, today the Sawyer project is all but destroyed and is a wasting asset. We have become a much-publicized example of the problems encountered by U.S. investors in Russia.

Despite these events, I remain positive about Russia, and believe that many courageous reforms are underway that someday will allow Russia to realize the full potential of its natural, human and cultural resources—a rightful expectation of Russian citizens and leaders. I further believe that American friendship is critical and valuable to Russia during this period of transition. I hope that my remarks and the Sawyer experience can serve as a catalyst for reform in Russia and help to advance the important bilateral objectives of the U.S. and Russia.

Now, let me summarize the main points of this testimony:

- I. There is fundamental lack of protection for intellectual property in Russia, which poses a substantial obstacle to direct investment by high-technology manufacturers.
- II. The lack of protection for Sawyer's intellectual property in Russia has created a threat to the competitiveness of Sawyer Research Products in the global marketplace.
- III. The lack of IPR protection threatens the achievement of a key bilateral objective of the U.S. and Russia, namely the full integration of Russia into the world economy.

In my conclusion, I will also present several recommendations to Congress on steps that can be taken to address these issues.

#### *Background on Sawyer Research Products, Inc.*

I would like to provide some brief background information on Sawyer Research Products, Inc. Sawyer is a global leader in the business and technology of single crystal piezoelectric materials, especially cultured quartz. Quartz is second only to the production of silicon in the ranking of crystal materials used in electronics. Quartz is the most widely used material used both to generate and to select electronic signals at precise frequencies. Common applications include telecommunications and digital electronics (mobile telephones and computers, for example).

C.B. Sawyer founded Sawyer Research Products, Inc. in 1956 after more than 10 years of work to advance research begun in Germany during World War II as part of a strategic initiative to improve military communications. Sawyer Research was the first company to synthesize quartz crystals for technical use. Today, with over 10 significant producers worldwide, Sawyer remains a leader both in the value of quartz produced and in the technology necessary to produce material at the highest performance levels. Sawyer has committed nearly 50 years of technical refinement and investment to create the body of intellectual property that today remains the most important factor in the success of the company. As we sometimes say, "Research is our middle name." Sawyer strives to do business around the world as a good corporate citizen, contributing development and opportunity for our local partners, while creating profit and long-term strategic advantage.

I am an engineer and businessman with nearly 30 years of experience in high technology and international businesses. I joined Sawyer in 1979 as a sales manager

and today serve as chairman, president and chief executive officer. Also, I participate in a variety of activities related to our industry community, including my roles as chairman of the International Electrotechnical Commission Technical Committee 49 (piezoelectric materials), as trustee of the Piezoelectric Devices Association, and as vice chair of the technical program committee of the International Frequency Control Symposium. I am also co-chair of a group of small and medium-sized (SME) businesses in Russia, whose investments are in jeopardy. While the members of this group seek to resolve their individual disputes, they also, through their collective experience, seek to identify and illuminate broader policy issues for government consideration.

I. THERE IS FUNDAMENTAL LACK OF PROTECTION FOR INTELLECTUAL PROPERTY IN RUSSIA, WHICH POSES A SUBSTANTIAL OBSTACLE TO DIRECT INVESTMENT BY HIGH-TECHNOLOGY MANUFACTURERS.

To operate manufacturing operations in foreign locales, U.S. companies must transfer critical technology. The inability of Russia to insure the intellectual property transferred by foreign investors raises a significant investment barrier, while threatening the future competitiveness of currently active direct investors. Because U.S. high-technology companies rely heavily on their technical advantages to compete successfully around the world, the inadequate protection of valuable intellectual property threatens the competitiveness of the high-technology manufacturing segment of the U.S. economy.

The Sawyer case illustrates the fact that fundamental IPR violations pose a serious obstacle to investment in the high-technology industry.

On July 15, 1997, the OAO "Quartz Glass Plant" ("QGP"), a former state enterprise located in Goose Khrustalny in the Vladimir region, leased a shop ("Shop 5") holding 80 high-pressure quartz growth reactors (autoclaves) to Sawyer Research Products for 25 years. QGP had been placed in bankruptcy in 1995. Under the lease, which was executed pursuant to the external reorganization plan adopted by the QGP creditor's committee on April 4, 1997, Sawyer was required to pay \$1.5 million in the first three years, which QGP would use to pay its social debt. The 25-year lease also provided that in the first five years Sawyer invest up to \$3 million in capital required to repair and upgrade Shop 5 and up to \$7 million in working capital to finance operations.

*Sawyer's Intellectual Property Investment in Russia*

Sawyer's injection of intellectual property into its Russian investment was a vital element in its program to elevate the production capability of the existing equipment to produce material to world-class performance standards using Russian workers. Sawyer identified, modified, and installed advanced process control systems and techniques for the crystal growth process. The technical staff of Sawyer adapted to the Russian facility the proprietary "recipes" developed over many years in the U.S. and requiring a major investment in experiments and analysis. Upgraded metrology equipment and methods required to assess quality were introduced. Russian technologists were trained in Sawyer's U.S. facilities to educate them in the advanced quartz growth process skills developed by Sawyer. Sawyer introduced quartz-cutting technology to process the seeds required in production. Seed processing increased the technical and manufacturing value contributed to the operation, in addition to making it more self-sufficient.

Moreover, Sawyer provided the Russian operation with seed stock that has superior shape, size and structural perfection. Sawyer's seed stock, developed over many years and using a variety of proprietary techniques, is unique in the industry and establishes economic and competitive advantages for Sawyer difficult to re-create and as yet unmatched by others. The technology is embodied fully in the seeds themselves.

Sawyer's objective was to produce 10 percent of the world's high-quality, electronic-grade quartz in Goose Khrustalny and export it to international markets, employing Russian technical managers and personnel.

On February 9, 2001, after Sawyer had completed paying the \$1.5 million to QGP for payment of social debt, invested over \$1.5 million in capital improvements and repairs to produce world standard quartz, and contributed over \$3.2 million in working capital and inventory to begin operating, the Vladimir Arbitrage Court ruled that the 25-year lease between QGP and Sawyer was void. Sawyer was in full compliance with the lease, which was duly registered by the Goose Khrustalny Branch of the Center for Registration of Real Estate on September 17, 1997. Sawyer had executed the lease in a manner that fulfilled the QGP external reorganization plan's objectives in all material respects.

The Vladimir Arbitrage Court's February 9, 2001 decision was based on a lawsuit filed by the Office of the Federal Procurator of the Vladimir Oblast on May 16, 2000. The Federal Procurator claimed that QGP's external bankruptcy manager exceeded his authority under the 1997 external reorganization plan when he executed the lease. The plan expressly provides that Shop 5 shall be leased to Sawyer for 20–25 years. The plan envisioned that QGP would create new companies wholly owned by QGP to lease each of QGP's eight idle workshops, including Shop 5. Exercising certain discretion provided under Article 12 of the law on "On Insolvency (Bankruptcy) of Enterprises" and Article 53 of the Civil Code, the QGP external manager did not create a new company for Shop 5 and decided that QGP could lease this shop to Sawyer directly.

Nevertheless, on the basis of the Federal Procurator's claim, the Vladimir Arbitrage Court declared the lease void *ab initio*, or "from the beginning". Sawyer was ousted from the premises of Shop 5 on June 4, 2001 after losing an appeal of the Vladimir Arbitrage court ruling on May 15.

As a result, Sawyer lost both the revenue required to recover its up-front investment and the profits to be derived from operating Shop 5 for the remaining 21 years of the 1997 QGP-Sawyer lease. At the time it was ousted, Sawyer was exporting \$300,000 per month of world standard quartz to top international customers on the basis of long-term contracts.

For more details on the legal history of Sawyer's investment in Russia, please see the attached Annex.

## II. THE LACK OF PROTECTION FOR SAWYER'S INTELLECTUAL PROPERTY IN RUSSIA HAS CREATED A THREAT TO THE COMPETITIVENESS OF SAWYER RESEARCH PRODUCTS IN THE GLOBAL MARKETPLACE.

Sawyer is a small and medium-sized enterprise (SME) with international reach occupying a leading position in a critical technical material. From the beginning, the company has recognized the overarching importance of a competitive advantage in technology to survival. Sawyer has international production and distribution networks, which have included operations and joint ventures in the United States, China, Japan, Malaysia, Russia, and South Korea. Yet Russia is the sole country where Sawyer has had its intellectual property taken.

Not only has Sawyer suffered substantial financial and material losses in Russia, especially damaging is the fact that Sawyer's proprietary seed stock is now available to a potential competitor, thus creating the risk of further proliferation in the industry and thereby threatening to undermine an important and valuable competitive advantage in the global marketplace.

Bringing substance to the threat, Sawyer is aware of efforts undertaken by VPQG and affiliated Russian companies to sell inventory removed from Sawyer control as well as material completed from the work in progress seized in June 2001, all produced using Sawyer seeds and other proprietary technology. The Russian newspaper *Prizyv* on February 20, 2003, in an article attributed to the General Director of VPQG, reported sales by VPQG to Japan, South Korea, China, and Taiwan.

## III. THE LACK OF IPR PROTECTION THREATENS THE ACHIEVEMENT OF A KEY BILATERAL OBJECTIVE OF THE U.S. AND RUSSIA, NAMELY THE FULL INTEGRATION OF RUSSIA INTO THE WORLD ECONOMY.

As part of Russia's economic transformation and continued integration into the world economy, advancing Russia's high-technology industry is a stated objective of the Russian federal government. On March 20, 2002, President Vladimir Putin announced that it is imperative that the Russian Federation advance beyond dependency on the export of natural resources to create an industrial base for exporting value-added, high-technology products. In particular, he identified an initiative to wean Russia of its dependency on natural resources by stating, "There is a possibility to reduce dependence on the export of irreplaceable resources—timber, gas, oil—and do that by the export of artificial crystals." Thus, he urged Russia to develop the very type of project in which Sawyer invested over \$8 million in Vladimir.

Sawyer's experience directly contradicts this presidential mandate. A campaign initiated and guided by local government officials and utilizing government institutions in Vladimir resulted in the "creeping expropriation" of Sawyer's physical and intellectual property. Such projects with significant technical content are highly attractive targets. SMEs such as Sawyer, which lack both strong political networks and the resources to sustain protracted defenses of their property rights in local courts, are especially vulnerable in Russia. The judiciary, acting according to "state interests" as defined by the procurator, was the primary instrument deployed to take over Sawyer's business and to provide a certain level of justification and sanc-

tity to an economically destructive and institutionally corrosive outcome. Not only has Sawyer suffered significant damages, but Russia has also lost an attractive economic development opportunity, while establishing a dangerous precedent and ignoring a critical challenge to federal authority.

The inability of Russian federal reforms to insure the impartial functioning of institutions to protect investor rights, as seen in this well-known case, threatens the achievement of a key bilateral objective of the U.S. and Russia: the full integration of Russia into the world economy. The U.S. government's bilateral mechanisms for addressing Russia's IPR violations are not new to Congress. The United States Trade Representative (USTR) is required to prepare an annual report for Congress that identifies countries around the globe that do not adequately protect the rights of intellectual property owners. Based on USTR's assessment of the conditions of IP protection, a country may be named to a list of: 1.) Priority Foreign Countries (the most egregious); 2.) the Priority Watch List; or 3.) the Watch List. For the past few years, Russia (along with other trading partners) has been placed on the Special 301 Priority Watch List.

Resolution of the Vladimir investment dispute falls under the mandate of the "Joint Declaration of The United States of America and the Russian Federation" signed by President George Bush and President Vladimir Putin on May 24, 2002, which states in pertinent part that: "We have established a new dynamic in our economic relations and between our business communities, aimed at advancing trade and investment opportunities while resolving disputes, where they occur, constructively and transparently." A transparent resolution of the Vladimir investment dispute would help meet several objectives set forth in the May 24, 2002 Joint Declaration, including "... respect for the discipline and practices of the free market ... freedom of economic choice", [and making] "use of the potential of world trade to expand the economic ties between the two countries, and to further integrate Russia into the world economy as a leading participant, with full rights and responsibilities, consistent with the rule of law ..."

After being denied protection through judicial process in Russia, Sawyer approached other government agencies both in the United States and in Russia interested in advancing the bilateral economic agenda and promoting the implementation of key reforms initiated under the Putin Administration.

U.S. Ambassador to Russia Alexander Vershbow and his staff have pursued vigorously the resolution of the Sawyer and other SME disputes. Further assistance has come from the Department of Commerce and the Office of the Trade Representative. Congressional support has included a letter from Senator George Voinovich to draw the attention of The White House to the Sawyer case and to the importance of the issues raised.

Sawyer has also received strong support from the U.S. government to pursue resolution through multiple channels of the Russian government. The Sawyer case also has been raised with the Plenipotentiary Presidential Representative of the Central Region; the Ministry of Economic Development and Trade; the Ministry of Justice; and the Deputy Head of the Presidential Administration responsible for judicial reform, among others.

Nevertheless, this bilateral investment dispute is unlikely to be resolved until the Russian government adopts a clear position regarding the federal policy and procedure that it has followed in the Federal Procurator's case against Sawyer to date, and that which it will follow in similar circumstances against other U.S. investors in the future.

### *Conclusion*

In order to secure immediate Russian government action on the Vladimir investment dispute, and thereby demonstrate a commitment to further the rule of law (especially as it applies to foreign investors and to SMEs in particular), I would like to offer the following recommendations to the U.S. government.

- To continue to hold hearings such as this to raise awareness and to identify appropriate legislative initiatives to address the fundamental rule-of-law issues raised by the systematic abuse of property rights, including intellectual property, in Russia;
- To work with your colleagues in the U.S. Executive Branch (State Department, Commerce Department, USTR, etc.) to identify appropriate costs that could be imposed on Russia as a result of its disregard for the rule of law (treaty violations, expropriation cases, etc.);
- To support U.S. funding for rule-of-law initiatives in Russia, especially in the area of enforcement; and,

- To work with your counterparts in the Russian Congress (“Duma”) to get a commitment to resolving these violations and disputes.

Thank you very for your interest in this matter and for the opportunity to introduce you to the situation faced by Sawyer Research in the course of doing business in Russia.

#### ANNEX: LEGAL HISTORY

##### *A Victim of “Creeping Expropriation”*

After the QGP-Sawyer lease was signed in July 1997, Sawyer created a wholly-owned subsidiary ZAO “Russian Quartz”, which employed and trained over 130 Russians to conduct the quartz-growing operation at Shop 5.

The Vladimir regional government, led by the Governor and Deputy Governor for Economic Development, then invited two Russian companies, OAO “ROEL Contract” and ZAO “Vladimirtechnoservice”, to take control of QGP and initiate lawsuits to oust Sawyer and “keep the plant for Russia”. (See articles in *The Moscow Times*, July 27, 2001, p. 1 and August 2, 2001, p. 5, quoting ROEL representative Vladimir Dorokin.) After acquiring a majority of the debt in QGP (81%), on December 1, 1999, ROEL and Vladimirtechnoservice, took steps to secure control of Shop 5. They transferred all of QGP’s assets of value, including Shop 5, to a new company, OAO “Very Pure Quartz Glass” (“VPQG”).

In order to take control of Sawyer’s operation at QGP, the Vladimir regional government and VPQG required a means to attack a valid contract, one duly registered by the Goose Khrustalny Center for Registration of Real Estate. Accordingly, the administration secured the support and assistance of the local offices of federal government agencies. Working together with the Office of the Federal Service of Russia on Insolvency and Bankruptcy Matters of the Vladimir Oblast and the Office of the Federal Procurator of the Vladimir Region, they influenced a Vladimir Arbitrage Court to void the QGP-Sawyer 25-year lease retroactively.

On August 31, 1999, the QGP liquidation manager notified Sawyer that the Vladimir Office of the Federal Bankruptcy Service had ordered the termination of the QGP-Sawyer lease because Shop 5 was allegedly part of Russia’s emergency mobilization reserve plan. On September 7, 1999, the Mayor of Goose Khrustalny wrote a letter to the employees of Russian Quartz advising them why the government must be involved in determining future control of Shop 5. On February 25, 2000, the Head of the Department of Industry of the Vladimir administration, warned Russian Quartz employees that they would be transferred to the employ of VPQG.

Subsequently, the Governor of Vladimir secured the participation of the Federal Procurator in the effort to oust Sawyer from Shop 5. On March 13, 2000, the Deputy Governor for Economic Development advised Sawyer that the Vladimir government had requested the Federal Procurator to take legal action to oust Sawyer due to Sawyer’s alleged “refusal” to comply with the national mobilization reserve plan.

In order to assert jurisdiction in a private commercial matter, the Federal Procurator’s May 16, 2000 suit claimed that “state interests” prevented Shop 5 from being leased to Sawyer because it was part of Russia’s emergency mobilization reserve plan. As discussed above, this particular claim, however, was not the basis of the Vladimir Arbitrage Court’s decision to void the 25-year lease. In fact, Russian law permits assets under Russia’s mobilization reserve plan to be leased to foreign parties. Moreover, the Federal Procurator failed to produce evidence that Shop 5 was under the plan. On February 9, 2001, the Vladimir Arbitrage Court rejected the Federal Procurator’s claim regarding the mobilization reserve plan.

Once the Federal Procurator sued a foreign investor at the request of the Governor of Vladimir in a Vladimir court, however, the outcome of the case was assured. Although the Vladimir Arbitrage Court rejected the Federal Procurator’s primary claim against Sawyer on February 9, 2001, as discussed above, it voided the lease on the grounds of a secondary claim—that QGP’s external bankruptcy manager exceeded his authority.

In addition, as a result of the Federal Procurator’s assertion of jurisdiction, Sawyer was deprived of fundamental legal rights guaranteed by Russia’s Constitution, including the right to a fair trial and the protection of the statute of limitations. In July 2000, the Chief Procurator of the Vladimir Region sent a letter to the Vladimir Arbitrage Court stating that the procurator was not subject to Article 8.3 of the QGP-Sawyer lease, which provided Sawyer the right to submit any dispute over the lease to binding resolution before the Court of Arbitration of the Stockholm Chamber of Commerce. On July 6, 2000 the Vladimir Arbitrage Court stripped Sawyer of it right to submit the case to arbitration in Stockholm.

The Vladimir Arbitrage Court’s finding that QGP’s external manager exceeded his authority in 1997 did not justify the drastic remedy of voiding the lease retroactively

in 2001. In fact, under Russian law, a suit to void a lease must be brought within a statute of limitations of three years. As the Federal Procurator was acting in the name of “state interests”, however, the Vladimir Arbitrage Court waived the statute of limitations. With the assistance of the Vladimir administration, VPQG sought and the local court granted a remedy that would not otherwise have been available to VPQG as a private claimant.

Though the Federal Procurator was purportedly seeking to protect “state interests”, VPQG was a claimant in and a private beneficiary of the Federal Procurator’s suit to void the QGP-Sawyer lease. As a result of the participation of both the Vladimir government and the Vladimir offices of federal government agencies, however, Sawyer has grounds to make a legal claim directly against the Russian federal government for expropriation. Under international law, when “state action” is used to take a foreign investor’s assets, the investor can claim just and immediate compensation from the government. Although the Russian federal government may not have made an official decision to expropriate Sawyer’s investment, the company has been the object of “creeping expropriation”, whereby a series of actions by different government agencies resulted in having its assets confiscated.

#### *Sawyer Prevented from Recovering Investment or Property*

After ousting Sawyer from the plant in June 2001, VPQG illegally took control of Sawyer’s property in order to begin operations. This property included fixed assets, without which Shop 5 could not operate, inventory and other items with a total value of approximately \$3.5 million. It also included this substantial body of intellectual property transferred from Sawyer.

In its February 9, 2001 ruling declaring Sawyer’s 25 year lease void *ab initio*, the Vladimir Arbitrage Court awarded Sawyer \$1.7 million in damages to compensate for certain social debt and lease payments. This award was upheld on May 15 at the first level of appeal. \$1.4 million of this award, however, was supposed to be paid to Sawyer by QGP, which was bankrupt. VPQG was required to pay only \$280,000 to Sawyer. In any event, on July 31, 2001, the Federal Arbitrage Court of the Volgo-Vyatsk Region in Nizhny Novgorod (“Cassation Court”) overturned the entire damages award. As a result, Sawyer is not entitled to recoup any direct financial damages suffered due to the retroactive voiding of the lease.

On July 25, 2001, the Vladimir Arbitrage Court issued an injunction prohibiting VPQG from using or alienating Sawyer assets, inventory and other property. During the following two months, the Bailiff’s Office, which was charged with auditing the property inside QGP, was denied access to the plant by VPQG. In August 2001, the Vladimir Arbitrage Court declared the Bailiff’s Office’s failure to enforce its decisions illegal. Since that time, despite court orders requiring the return of Sawyer’s property, the federal government agency responsible for enforcement, the Office of the Bailiff of the Ministry of Justice (“Bailiff’s Office”), has failed to return or protect Sawyer’s property.

Despite the July 25 Vladimir Arbitrage Court injunction, VPQG has not only refused to return Sawyer’s assets, they have been damaged, concealed and/or sold. On October 10, 2001, the Bailiff’s Office reported that during an inspection of Shop 5, it found only 6 percent of the property Sawyer was forced to leave on the QGP premises as of June 2001, with a value of about \$200,000. Although Russian law requires the Bailiff’s Office to take all necessary steps to find the property that was not identified during the inspection, it has failed to do so. It is common knowledge that the missing Sawyer property is held by VPQG on the territory of QGP and the All Union Institute for Mineral Synthesis (“VNIISIMS”), the state-owned enterprise in Alexandrov.

VPQG has refused to comply with orders of the Bailiff’s Office and the latter has acquiesced. Vladimir administration officials have openly facilitated this arrangement. According to the “Minutes of Enforcement” prepared by the Bailiff’s Office, upon entering the premises of QGP to enforce a court order on September 18, 2001, the bailiffs were told to cease the proceedings because Vladimir’s Deputy Governor for Economic Affairs was visiting the plant.

Ultimately, the Office of the Bailiff appears to have adopted a policy of enforcing the law selectively in order to help regain local control of QGP. In an article in the January 11–17, 2002 edition of the Vladimir newspaper, *Tomiks*, the Chief Bailiff of Vladimir Region stated that he sometimes refrains from enforcing court judgments if the end result is that an investor from outside the Vladimir region will obtain control of a facility within the region.

On January 8, 2002, the Vladimir Governor wrote to the Russian President requesting that he provide VPQG “protection from unfair competitive opposition from large foreign companies” in the area of production of electronic grade quartz.



On March 26, 2002, the Cassation Court in Nizhny Novgorod used the Governor's letter to President Putin as evidence to decide that Sawyer actually owes VPQG \$265,000.00 in damages for its use of Shop 5. Citing the lease as void *ab initio*, the Cassation Court ruled that Sawyer unjustly benefited from a lease that was never valid. As a result of the Cassation Court ruling, in April 2002, VPQG and the Office of the Bailiff attached all of Sawyer's property, assets and inventory, claiming that they are needed as security for collection of the judgment against Sawyer. To complete the takeover of Sawyer's property, inventory and assets, on October 10, 2002, VPQG announced to the Bailiff's Office its intention to bankrupt and liquidate Sawyer's subsidiary, Russian Quartz, the title owner of the Sawyer property.

As a result of the March 26 Cassation Court decision and the Bailiff's Office's policy of selective enforcement, it is practically impossible for Sawyer to recover its property or otherwise mitigate the damages it suffered when it was expelled from QGP. At the same time, VPQG has not only refused to return Sawyer's \$3.5 million in property, it has been allowed to use said property for its commercial benefit—both by operating Shop 5 with Sawyer's equipment and by selling Sawyer's inventory.

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PREPARED STATEMENT OF MICHAEL NEWCITY

I would like to thank Chairman Smith, Congressman Berman, and the other distinguished members of the Subcommittee for the opportunity to present my views on the thorny problem of copyright piracy in Russia and the appropriate U.S. response.

I am the Deputy Director of the Center for Slavic, Eurasian, and East European Studies at Duke University, where I teach courses on the Russian legal system. I am a lawyer by profession and have studied the Soviet, now Russian, legal system for almost thirty years. The major focus of my research and scholarship has been intellectual property protection and, in particular, copyright law in Russia. I have authored or contributed to several books and many articles on the subject and have testified extensively as an expert witness on Russian copyright law in various U.S. federal and state courts.

In 1995, the American Chamber of Commerce in Russia conducted a survey of its members to identify the most pressing issues relating to foreign trade and investment in Russia. The business people who responded to this survey identified four major trade and investment issues:

- Taxation
- Corruption
- Intellectual property rights violations
- Problems with standardization and licensing<sup>1</sup>

That the lack of effective legal protection of intellectual property rights was and remains a major concern to foreign business people in Russia is hardly surprising. The Russian Federation and the Soviet Union before it (and, for that matter, the Russian Empire, before it) have had long-established traditions of pirating the copyrighted works of foreign authors. The present-day magnitude of the problem is enormous. According to the International Intellectual Property Alliance, pirated versions of copyrighted works have captured an enormous share of the total market for copyrighted works, and in some specific markets pirated versions represent over 90 percent of the market.<sup>2</sup> In Table 1, which is compiled from data collected by the International Intellectual Property Association, losses sustained due to copyright piracy in Russia during each of the past eight years as well as the percentage of the market for copyrighted products captured by pirated products are estimated. According to these estimates, copyright proprietors lost almost \$756 million in lost trade in 2002 and a total of almost \$7 billion during the past eight years as a result of copyright piracy in Russia.

The enormity of the copyright piracy problem in Russia is obvious to anyone. The Russian government has finally begun to recognize that this is a significant problem since intellectual property piracy not only discourages foreign investors, but it deprives the Russian government of sorely-missed tax revenues. Russian officials have

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<sup>1</sup>*Journal of Commerce*, July 27, 1995, p. 6A.

<sup>2</sup>International Intellectual Property Alliance, *2003 Special 301 Report* (2003), at 254. The text of this report is available from the IIPA's website, [www.iipa.com](http://www.iipa.com).

estimated that the Russian government and foreign companies lose over \$1 billion each year due to copyright piracy.<sup>3</sup>

The pervasiveness and intractability of this problem is obvious to anyone who spends even a little time in Russia. As the following examples illustrate, the infringement of copyrights there is open, brazen, and pervasive:

- Russian markets and kiosks are fully of pirated computer software, videos, audio CDs, and books, which are displayed and sold openly. Collections of computer software are sold for \$3–\$4, audio CDs are sold for \$2, and videos of recently-released Hollywood movies are sold for \$3.<sup>4</sup>
- The Russian public and many Russian government officials appear wholly indifferent to copyright piracy. When the Russian media reported that officials would close Gorbushka, a Moscow market noted for its stalls that sell pirated videos and audio CDs, the Russian Minister of Internal Affairs visited the market and reassured shoppers and stall-keepers that the market would not be closed. A telephone poll conducted by a Russian television network recently posed the question, “Should Russia fight against piracy?” Of those responding, 7,804 answered “no” and 3,420 answered “yes.”<sup>5</sup> (Gorbushka and its vendors of pirated CDs and other works remain in business. As one such vendor noted, commenting several months ago on government attempts to stifle copyright piracy, “Every year, the authorities take steps to eradicate piracy but they have failed so far.”)<sup>6</sup>
- Pirated copies of Microsoft’s operating system, Windows 2000, were on sale in Moscow for approximately \$3 for several months prior to its official roll-out in the United States in early 2000.<sup>7</sup>
- One day after *Star Wars, Episode 1: The Phantom Menace* was released in the United States, pirated copies of the film were available for sale in Moscow pirate markets.<sup>8</sup>
- A young Russian film director completed a movie in Russia, only to see pirated copies of it circulating in Russia’s video stores and being broadcast on television within weeks of its commercial release. When asked whether he would consider going to court to protect his rights, the director said that “Everything is corrupt and there is nowhere to turn. . . .” “To go to court is expensive and besides, it just means more bribes.”<sup>9</sup>
- The world premiere of a movie version of Vladimir Voinovich’s novel, *The Life and Extraordinary Adventures of Private Ivan Chonkin*, was scheduled for showing at a film festival. As the lights went down to begin showing the film, its producers noticed that video equipment had been set up throughout the theater and that some members of the audience were pulling small video cameras out of their bags in order to pirate the film. The producers then withdrew the film from the festival.<sup>10</sup>
- The book and movie of *Gone with the Wind* have been extremely popular in Russia, so much so that book stalls there have been flooded with unauthorized sequels to the book, written by Russian authors under pseudonyms. These sequels have involved every conceivable permutation of events and characters from the original: In some, Scarlett lives, in others she dies, and still others explore the circumstances of her birth. As the manager of the trading company that distributes these books stated, “Copyright laws are like all laws in Russia. We have them, but nobody ever abides by them. It’s getting to be an epidemic.” The people behind these books were certainly aware of copyright law requirements. According to Russian press accounts, the distribution of these books was organized so that the books are published in Belarus, which at that time had not yet adopted new copyright legislation. As

<sup>3</sup>“Firms Instruct Customs on Piracy,” *The Moscow Times*, September 24, 1998.

<sup>4</sup>Sergei Blagov, “Copyright Piracy Runs Rampant,” Inter Press Service, December 21, 1999, LEXIS-NEXIS.

<sup>5</sup>Brian Humphreys, “Officials: Pirated CD Market to Stay,” *The Moscow Times*, March 2, 2000.

<sup>6</sup>Interfax News Agency, published in BBC Worldwide Monitoring, October 5, 2002, LEXIS-NEXIS.

<sup>7</sup>“Windows 2000 Launched In Russia—By Pirates,” *Newsbytes*, February 18, 2000, LEXIS-NEXIS.

<sup>8</sup>Ben Aris, “In Russia, Intellectual Property Pirates Run Rampant,” Cox News Service, December 3, 1999.

<sup>9</sup>*New York Times*, February 28, 1994, sec. C, at 11.

<sup>10</sup>*The Moscow Times*, October 18, 1994.

one of those involved said, "The books are written by citizens of Belarus, and Belarus has no copyright laws. So we have rights without limits."<sup>11</sup>

- Russian textbook authors and publishers have suffered severely as a result of piracy of textbooks. In 1996 and 1997 two executives of Russia's largest commercial publisher of textbooks were shot to death. According to an article in *The Chronicle of Higher Education*, "[t]he two murders . . . were linked . . . by the role each [of the victims] had apparently played in investigating cases of publishing piracy." Officials of the publishing house that both murder victims worked for believe that they were killed because they were collecting information for a police investigation.<sup>12</sup>

The problem with the protection of copyright in Russia stems primarily from the weak implementation and enforcement of copyright legislation, not from the substantive provisions of the law itself. The 1993 Law on Copyright and Neighboring Rights was drafted so that Russia would qualify for accession to the Berne Convention for the Protection of Literary and Artistic Works, which Russia joined in 1995. As such, this law is certainly up to world standards for copyright legislation and provides the legal basis for protecting the rights of Russian and foreign copyright proprietors. Moreover, since this law was adopted, Russian criminal law was amended to make copyright piracy a serious offense.

The weakness in the Law on Copyright and Neighboring Rights is that it is vague on the enforcement powers granted to Russian courts. Another glaring deficiency in Russian copyright legislation is that it does not provide for the restoration of the works of foreign authors that were previously in the public domain. But despite these and a few other deficiencies and gaps in the legislation, the legislation is certainly workable. Nonetheless, copyright is difficult to protect in Russia. Piracy is virtually pandemic throughout Russia, involving both pirated works manufactured in Russia as well as those imported from Bulgaria, Ukraine, China, and elsewhere. The problem of piracy in Russia is now not isolated just to the Russian domestic market, since pirated products manufactured in Russia have turned up in shops in countries around the world. As Jack Valenti illustrated in his testimony to the Subcommittee, the distribution of pirated optical media products (music CDs, video games, video CDs, and DVDs) from Russia is an especially acute problem.

The Russian government has taken some steps to fight copyright piracy, and Russian authors, recording artists, and other copyright proprietors have begun to take concerted action as well. However, to date, the Russian government's record on this issue has been decidedly mixed at best. It has sponsored anti-piracy announcements on television, the police have raided kiosks and street stalls that sell counterfeit and pirated goods, customs officials have been involved in preventing the importation into Russia of pirated products, and at least one television station has had its license revoked. The Interior Ministry has established a unit to fight piracy, the Intellectual Property Police. In Moscow in 1999, the police conducted approximately 300 such raids and seized tens of thousands of counterfeit video tapes and pirated CD-ROMs. However, only 75 individuals were fined as a result of these actions and only 10 criminal investigations were begun. Only one conviction for intellectual property piracy has been obtained. Thus, while the laws themselves are reasonably acceptable, the enforcement of those laws so far has been ineffective.

A more serious problem, and one that was elaborated upon in the testimony of Joan Borsten Vidov, Mr. Valenti, and other witnesses before the Subcommittee, is the involvement of high-ranking government officials in copyright piracy activities. The enforcement of copyrights and neighboring rights in Russia obviously depends on the energy and resources that Russian officials devote to enforcing these laws. Individuals and private organizations can initiate lawsuits in Russian courts to protect their copyrights, but, as Ms. Borsten Vidov's experience illustrates, the courts frequently look to the government for guidance. Even if a judgment is obtained, the courts' powers to enforce judgments are ill-defined and limited. Thus, to a much greater degree than is true in the United States and many other countries, individual citizens and organizations will not be able to effectively protect their copyrights and other intellectual property rights themselves, either directly or through the courts, since the courts, police, prosecutors, customs, and other agencies will look to the government for leadership. The Russian government must take the lead in enforcing the rights of copyright owners.

The major challenge, then, is to persuade the Russian government at the very highest levels to establish the protection of copyright and other intellectual property

<sup>11</sup> *Christian Science Monitor*, August 29, 1994, at 1.

<sup>12</sup> Byron MacWilliams, "In Russia, Textbook Publishing Involves Red Tape, Piracy—and Murder," *The Chronicle of Higher Education*, October 30, 1998, at A1, A53.

rights as a priority. Accomplishing this will be difficult since some government officials and some private individuals who have influence with the Russian government are obviously profiting enormously from the illegal trade in pirated works.

The leaders of the Russian government—President Putin and his key ministers and advisers—must be made to understand that Russia has more to lose if they continue to flout international copyright protection norms than if they provide meaningful and effective enforcement for the legislation that is already on the books.

It must be made clear to President Putin and his advisers that continued failure to effectively protect copyrights will delay Russia's admission as a full member of the World Trade Organization. In addition, improvement in Russia's bilateral trade relations with the United States should be conditioned on a solution to the problem of copyright piracy. In 1995, the United States Trade Representative placed the Russian Federation on the official Watch List, a list of countries that are officially designated by the U.S. government as having "the most onerous or egregious acts, policies, or practices that deny adequate and effective protection" to U.S. intellectual property. The continued failure of a country to address the issues that have landed it on the Watch List may result in the imposition of trade sanctions by the U.S. government. In 1997, the Russian Federation's status was downgraded and it was placed on the Priority Watch List, where it has remained to date.

The history of copyright protection in Russia makes very clear that the protection of foreigners' rights is only improved when significant pressure is brought to bear by foreign governments, especially the United States. Over the past half century, the rights of foreign owners of intellectual property have been materially upgraded on four separate occasions. In 1965, the USSR adhered to the Paris Convention for the Protection of Industrial Property, which was the first time since the Bolshevik Revolution that the Soviet government had willingly joined an international agreement (bilateral or multilateral) for the protection of intellectual property. The impetus for this action was a desire on the part of the Soviet government that in order to acquire Western technology, which it coveted, it would be necessary to provide for the legal protection of that technology in the USSR. Otherwise, the Western owners of the technology would be unwilling to license their technology to Soviet organizations.

The most significant advance in the protection of foreign copyright proprietors' rights in the USSR occurred in 1973 when the Soviet Union acceded to the Universal Copyright Convention and for the first time in history granted broad legal protection in USSR to the works of foreign authors. This step forward was the direct byproduct of the intensive trade negotiations between the United States and the USSR that began in 1972. One of the special concerns of the Soviets in these negotiations was the legal protection abroad of Soviet technology. The Soviet government was desirous of expanding the sales and licenses of Soviet technology in the United States, but the Soviets believed that this would not be possible unless the U.S. eliminated the 30 percent withholding tax on royalties earned by Soviet organizations. In the commercial negotiations that followed in 1972 and 1973, the U.S. government negotiators offered to rescind the withholding tax if the Soviets would recognize the rights of U.S. copyright proprietors and compensate them for the use of their works. The culmination of this negotiation was Soviet accession to the Universal copyright convention.

In a later round of trade negotiations—the negotiations that led to the 1990 U.S.-USSR Agreement on Trade Relations—U.S. negotiators were adamant in insisting that the Soviets improve the level of intellectual property protection extended to foreigners as a precondition of a grant of most-favored-nation status.

The Agreement on Trade Relations advanced this process by including a commitment by the Soviets to a thorough-going reform of their intellectual property laws and included very specific features that were to be included in the new legislation. Article VIII of the U.S.-USSR Agreement on Trade Relations, which was signed by Presidents Bush and Gorbachev on June 1, 1990, required the preparation of draft laws to protect intellectual property, including copyright, patents, industrial designs, know-how, trade secrets, trademarks, and protection against unfair competition. These undertakings were made even more specific in a side letter sent simultaneously with the signing of the trade relations treaty by the Soviet Deputy Minister of Foreign Economic Relations, Yuri N. Chumakov, to the U.S. Trade Representative, Carla Hills. This letter, which the Agreement refers to as "an integral part of this Agreement,"<sup>13</sup> promised that the Soviet government would incorporate a detailed list of features into its intellectual property legislation:

<sup>13</sup> Art. VIII(4), Agreement on Trade Relations Between the United States and the Soviet Union, signed in Washington, D.C. on June 1, 1990, U.S. House of Representatives, 102d Congress, Doc. No. 102-148, p. 20.

The Agreement on Trade Relations also provided for the establishment of a joint U.S.-Soviet working group on intellectual property matters, whose brief, as spelled out in the Chumakov-Hills letter, included reviewing such issues as the extension of patent protection to products not previously patentable under Soviet law; the protection of integrated circuit layout design; the implementation of intellectual property laws; and the exchange of information and cooperation on intellectual property protection questions.

On May 31, 1991, the Supreme Soviet adopted new civil legislation, which included revised civil code provisions on patent, copyright, and other intellectual property rights. Among the reforms introduced by the new Fundamentals of Civil Legislation were the inclusion of computer software in the list of works covered by copyright, the extension of the term of copyright to the life of the author plus 50 years, a more elaborate statement of the copyright in recordings and broadcast programs, the elimination of provisions regarding the compulsory purchase of copyrights by the state, and the addition of provisions concerning the protection of know-how and trademarks.

The final cluster of legal changes that favorably affected the rights of foreign copyright proprietors was the adoption of the 1993 Law on Copyright and Neighboring Rights and the accession of the Russian Federation to the Berne Convention in 1995. The adoption of the Law on Copyright and Neighboring Rights was a direct outgrowth of the commitments made in the Agreement on Trade Relations in 1990. The Russian Federation had succeeded to the Soviet Union's obligations under this treaty and was intent on meeting the conditions precedent specified in the treaty to the grant of MFN status by the U.S.

Every time Soviet, now Russian, intellectual property protection of foreigners has been improved, the one constant factor has been the application of pressure by the U.S. government. Specifically, when it has been made clear that the improvement in trade relations and the expansion of technology transfers are conditioned on the improvement of intellectual property protection, the Russians have consistently responded favorably. Perhaps the steps taken by successive Soviet and Russian governments have been taken grudgingly and haltingly, but they have been taken. The lesson of this history is clear: The U.S. government must take the lead in pressuring the Russian government to respect foreign copyrights. Otherwise, protection of foreign copyrights in Russia will continue at the current halting, half-hearted pace.

Based on this brief review of the copyright piracy issue in Russia, I would advise that the U.S. government and, to the extent possible, interested U.S. corporations and trade organizations take the following steps:

1. **U.S. trade officials, especially the U.S. Trade Representative, must make it clear to the Russians that any consideration of Russia's membership in the World Trade Organization or other significant improvement in U.S.-Russian trade or commercial relations will occur only after Russia has substantially improved the enforcement of copyright protection and otherwise met the standards specified in TRIPS.**
2. **The U.S. government should insist on a reinvigoration of the joint U.S.-Russian working group on intellectual property matters that was established under the 1990 Agreement on Trade Relations and further insist that senior government officials and agencies from both governments are involved in the meetings of this working group. Moreover, the mandate of this working group could be broadened so that it could serve as a forum in which aggrieved intellectual property owners can seek resolution of their grievances.**
3. **The U.S. government, international organizations, and private corporations should assist the Russians in marketing their intellectual property abroad. If the Russian government and Russian companies are shown that they could earn substantial revenues from the licensing abroad of their copyrighted works and other intellectual property, but that to do so they must effectively protect foreign intellectual property in Russia, they might be more enthusiastic and willing to cooperate in protecting foreign intellectual property. This is an area where U.S. copyright-based industries in particular could be most active.**
4. **The U.S. government should strongly request that the Russian government seek ratification of the Bilateral Investment Treaty between the United States and the Russian Federation that was signed on June 17, 1992. This treaty has been signed and ratified by the U.S., but it has never been ratified by the Russian Duma. Though the Bi-**

lateral Investment Treaty does not address intellectual property protection specifically, its protections against discriminatory treatment, uncompensated expropriation, and submission of disputes to international arbitration would benefit U.S. investors who have had their investments in Russian, including intellectual property, confiscated or treated in a discriminatory fashion.

5. U.S. copyright-based industries should review their price structures and, if possible, lower them to meet competition from pirated sources. At present, pirated music CDs sell for \$2–3 each in Russia and licensed CDs cost \$15. With average monthly incomes throughout Russia in the \$100–150 range, the substantial price differential between pirated and licensed works is a huge factor supporting the demand for pirated works.

Though I believe that these steps, if taken, will result in a substantial improvement in the protection of foreign intellectual property in Russia, it would be naïve to assume that this situation will improve dramatically overnight. Instilling a respect for the rights of intellectual property owners is only a subset of the larger problem of instilling a respect for the rule of law in Russia. This larger task will involve overcoming a thousand years of experience and habit.

International and domestic efforts to encourage a respect for the rule of law in Russia have met with mixed success at best, which should not be surprising. Fashioning a new legal culture, one that is not premised on deference to authority and a profound distrust of the state, is no easy matter. Most international technical assistance programs have focused on encouraging a respect for the rule of law at the grassroots level. While this is important and ultimately indispensable, I think it is unlikely by itself to succeed. In Russian society, courts, police, government officials, and ordinary citizens take their cues from the top. As long as senior government officials ignore the rule of law, other members of society will ignore it as well. That is why I believe the most effective policy the U.S. government can pursue is to take the specific steps suggested above and, in a broader sense, encourage the leaders of the Russian government to act themselves in a lawful manner—in a way that shows that they respect the law.

Perhaps the most constructive policy that President Putin could undertake would be to initiate a government campaign to remove corrupt government officials and those who interfere in the workings of the courts and other judicial agencies, and to curtail the power of the oligarchs and criminal organizations. It is only when President Putin and his senior officials model a respect for the law themselves that others in Russian society will take the rule of law seriously.

Again, I would like to thank the Subcommittee for the opportunity to discuss this important issue.

**Table 1**  
**RUSSIA**  
**ESTIMATED TRADE LOSSES DUE TO PIRACY<sup>1</sup>**  
*(in millions of U.S. dollars)*  
**and LEVELS OF PIRACY: 1995-2002**

INDUSTRY	2002		2001		2000		1999		1998		1997		1996		1995	
	Loss	Level	Loss	Level	Loss	Level	Loss	Level	Loss	Level	Loss	Level	Loss	Level	Loss	Level
Motion Pictures	250.0	80%	250.0	80%	250.0	90%	250.0	90%	312.0	85%	312.0	85%	312.0	95%	312.0	99%
Sound Recordings/ Musical Compositions	371.9	66%	285.0	64%	250.0	70%	200.0	70%	170.0	75%	165.0	65%	170.0	70%	180.0	73%
Computer Programs	93.9	87%	90.6	87%	89.0	88%	134.5	89%	196.1	92%	174.5	89%	298.2	91%	216.9	94%
Business Applications																
Computer Programs: Entertainment Software	NA	90%	173.6	90%	NA	94%	241.1	95%	240.8	97%	225.8	95%	223.0	93%	189.9	91%
Books	40.0	NA	48.0	NA	48.0	NA	48.0	NA	45.0	NA	45.0	NA	45.0	NA	45.0	NA
<b>TOTALS</b>	<b>755.8</b>		<b>847.2</b>		<b>637.0</b>		<b>873.6</b>		<b>963.9</b>		<b>922.3</b>		<b>1048.2</b>		<b>943.8</b>	

<sup>1</sup> International Intellectual Property Alliance, *2000 Special 301 Report* (2000), at 138, and *2003 Special 301 Report* (2003), at 249. These reports are available on the IIPA's website, [www.iipa.com](http://www.iipa.com).

## PREPARED STATEMENT OF TIMOTHY P. TRAINER

The International AntiCounterfeiting Coalition (IACC) would like to thank the distinguished members of the Subcommittee for the opportunity to offer its views with respect to the links between intellectual property theft and organized crime and terrorism.

The IACC is a Washington, D.C.-based non-profit organization devoted solely to combating product counterfeiting and piracy. Formed in 1978, today it is comprised of a cross section of business and industry—from autos, apparel, luxury goods, and pharmaceuticals, to food, software and entertainment—the IACC's members' combined annual revenues exceed \$650 billion. The touchstone of the IACC's mission is to combat counterfeiting and piracy by promoting laws, regulations and directives designed to render the theft of intellectual property undesirable and unprofitable. The IACC serves as an umbrella organization, offering anticounterfeiting programs designed to increase protection for patents, trademarks, copyrights, service marks, trade dress and trade secrets.

Critical to the IACC's purpose is its belief that acts of counterfeiting create severe public health and safety hazards, as well as economic harm. The IACC supports government actions that will ultimately result in increased enforcement, lead to the prosecution of intellectual property infringers, and create a strong deterrent to counterfeiters and pirates. In pursuing its mission, the IACC provides law enforcement officials with information and training to identify counterfeit and pirate products and in the methods of product security to prevent the infringement of its members' intellectual property rights.

In an effort to create conditions under which its members' intellectual property rights are safe from illegal copying, infringement and other forms of theft, the IACC engages in substantive dialogue with governments and intergovernmental organizations worldwide. In pursuing its mission, the IACC provides law enforcement officials with information and training to identify counterfeit and pirate products and in the methods of product security to prevent the infringement of its members' valuable intellectual property rights.

## SCOPE OF INTELLECTUAL PROPERTY THEFT

There are no product lines, corporations, or consumers that escape the counterfeiters' and/or pirates' reach. Dangerous counterfeit products have appeared in retail stores across the United States. Organized crime is increasingly attracted by counterfeiting's high profits and relatively low criminal penalties. In addition, the manufacture, distribution and sale of counterfeit goods rob local economies of precious tax revenues, and costs Americans jobs.

Many pirate and counterfeit goods are not as visible as you might think. Many people think of the counterfeits and pirated products purely in terms of street vendors' products—music CDs, sunglasses, t-shirts, hats, cosmetics, cell phone covers, handbags and watches—bearing easily recognizable and known names and logos. But, on a different level, product counterfeiters and pirates are trading on names and logos often associated with things such as razor blades, shampoos, pharmaceuticals, foods, hand tools, auto parts, light bulbs, film, skin lotions, laundry detergent, band-aids, insecticides, batteries, cigarettes and practically anything else that bears a name that consumers are familiar with in the market place. Very few products, if any, are beyond the reach of skilled counterfeiters.

## PUBLIC HEALTH AND SAFETY DANGERS

Of particular concern to IACC members and consumers is the increasing availability of fakes that present severe health and safety risks. For example, the World Health Organization estimates that counterfeit drugs account for ten percent of all pharmaceuticals. That number can rise to as high as sixty percent (60%) in developing countries.<sup>1</sup> In another case, and according to a federal indictment made public in May 2002, U.S. Customs officials seized 59,000 bottles of counterfeit vodka in a Massachusetts warehouse. The fake vodka had been imported from a former Soviet

<sup>1</sup>The Engineer, *Fighting the Fakers*, at 16 (April 26, 2002); Phillippe Broussard, *Dangerous Fakes*, *World Press Review*, v44, n1, p36 (1) (January 1999). According to the *Shenzhen Evening News* (a government owned newspaper), approximately 192,000 people died in China in 2001 because of fake drugs. *China's Killer Headache: Fake Pharmaceuticals*, *Washington Post*, August 30, 2002. The same article goes on to state that, since 2001, Johnson & Johnson has established 38 criminal cases against different factories that copied its products in China.



republic.<sup>2</sup> In Estonia in 2001, illicit vodka containing methyl alcohol killed 60 people.<sup>3</sup> The problems, however, do not end with pharmaceuticals and alcohol.

In the 1990's, a major shampoo manufacturer was forced to place half-page advertisements in at least 27 national newspapers informing the general public that counterfeit versions of its shampoo were available in retail stores. Of particular concern to the manufacturer was the fact that the fake shampoo may have contained bacteria, risking infection in users with weakened immune systems.<sup>4</sup> Even more disturbing was the case where the operational life of counterfeit bearing seal spacers removed from a United Airlines plane were found to be only 600 hours—the genuine parts had an operational life of 20,000 hours. The fake parts came complete with fake boxes, labels and paperwork and were only discovered because of a very alert maintenance technician.<sup>5</sup> Finally, counterfeit-labeled infant formula found its way onto shelves in grocery stores in 16 states.<sup>6</sup>

For more examples relating to threats to the public health and safety, please refer to the attached document containing a list of relevant public source news articles and government reports compiled by the IACC.

#### LINKS TO ORGANIZED CRIME AND TERRORISM

In addition to the public safety issues, the IACC has spent years tracking the increasing influx of organized crime and terrorists into the lucrative under world of product counterfeiting and copyright piracy. These notorious organizations operate vast networks of counterfeit product distribution channels, and are often heavily involved in other criminal activity such as drug trafficking or money laundering.

Low risk of prosecution and enormous profit potential have made criminal counterfeiting an attractive enterprise for organized crime groups. Congress itself recognized organized crime's increasing role in the theft of intellectual property when it made both trademark counterfeiting and copyright piracy violations predicate acts under the federal RICO statute (see 18 U.S.C. §1961). The federal money laundering statutes (18 U.S.C. §§1956–57) similarly include trademark counterfeiting and copyright piracy violations as crimes that constitute the type of "specified unlawful activity" necessary for convictions under these statutes.

Recently, ties have also been established between counterfeiting and piracy and terrorist organizations that use the sale of fake and unauthorized goods to raise funds and launder money. Indeed, the United States Customs Service has explicitly stated that there is a link between terrorist organizations and intellectual property theft.<sup>7</sup> In addition, Operation Green Quest—a multi-agency task force established by the Treasury Department and aimed at identifying and dismantling the terrorist financial infrastructure—has specifically recognized counterfeit merchandise schemes as a source of terrorist funding.<sup>8</sup>

The attached list of public source news articles compiled by the IACC helps to detail, in alarming fashion, the extent of the connections between intellectual property

<sup>2</sup>Thanassis Cambanis, *Fancy Labels, Cheap Vodka Don't Mix*, *The Boston Globe*, May 2, 2002, at B1.

<sup>3</sup>The Engineer, *Fighting the Fakers*, at 16 (April 26, 2002).

<sup>4</sup>Henry Gilgoff, *Counterfeit: Rip-offs of Popular Products Victimize Both Consumers and Manufacturers*, *Newsday*, August 27, 1995. Fake toothpaste has also found its way into drug stores. *Colgate Warns People Against Fake Toothpaste*, *Austin American Statesman*, August 12, 1996.

<sup>5</sup>Billy Stern, *Warning! Bogus Parts Have Turned Up in Commercial Jets. Where's the FAA?*, *Business Week*, June 10, 1996, at 90.

<sup>6</sup>See Marian Burros, *F.D.A. Target: Baby Formula*, *N.Y. Times*, September 6, 1995; 142 Cong. Rec. 5776 (House). More recently, in 1999, the Food and Drug Administration (FDA) issued a warning regarding counterfeit cans of infant formula for infants allergic to milk protein. The warning came after some of the illicit product had already been purchased. The FDA warning stated that infants who ingested the counterfeit formula could experience fevers, skin rashes or severe allergic reactions. *FDA Warns About Infant Formula Fraudulently Labeled as Nutramigen in Southern California*, *HHS NEWS* (U.S. Department of Health and Human Services), P99–23, October 8, 1999. See also *Fugitive Who Sold Counterfeit Baby Formula Convicted of Federal Criminal Charges*, Department of Justice (Press Release), August 9, 2002, available at <http://www.cybercrime.gov/mostafaConvict.htm> (discussing the conviction of Mohamad Mostafa on charges involving a conspiracy to sell counterfeit infant formula; the defendant was also in the country illegally and upon indictment in 1995 fled to Canada where he was arrested in 2001).

<sup>7</sup>See Kathleen Millar, *Financing Terror, Profits from Counterfeit Goods Pay for Attacks*, *U.S. Customs Today*, November 2002, available at <http://www.customs.gov/custoday/nov2002/index.htm>; *Moving Up on the Outside, it's IPR Seizures*, *U.S. Customs Today*, May 2002, available at <http://www.customs.gov/xp/CustomsToday/2002/May/ost.xml>; NBC News Miami Affiliate interview of U.S. Customs Agent (broadcast February 4, 2003)(tape of broadcast on file with the IACC).

<sup>8</sup>See *Green Quest, Finding the Missing Piece of the Terrorist Puzzle*, available at <http://www.customs.ustras.gov/xp/cgov/enforcement/investigative—priorities/greenquest.xml>.

theft and organized criminal and/or terrorist groups and their potential devastating impact to both the American citizenry and economy. Consider just a few examples from that list:

- (1) In February 2003, federal prosecutors in Brooklyn, N.Y. charged six men with importing up to 35 million counterfeit cigarettes from China into the United States. The men were accused of importing the fake cigarettes, then selling them through a tax free business located at an upstate New York Indian reservation and also through the website <http://www.smokecheap.com>. The cigarettes were allegedly imported into the United States in 5 separate shipments through New Jersey ports over a two year period. The charging documents stated that the counterfeiters hid the cigarettes in shipping containers behind kitchen pots. According to the prosecutors, the men were under investigation in Europe for cigarette smuggling. Two of the defendants were also charged with importing counterfeit batteries from China via Lithuania.<sup>9</sup>
- (2) In 1996, the FBI confiscated 100,000 counterfeit T-shirts bearing fake and unauthorized Nike “swoosh” and/or Olympic logos that were intended to be sold at the 1996 Summer Olympic Games. The operation generated millions of dollars and was run by the followers of Sheik Omar Abdel Rahman—a blind cleric who was sentenced to 240 years in prison for plotting to bomb New York City landmarks. Authorities seized three floors worth of illicit merchandise, stacked seven feet high.<sup>10</sup>
- (3) There have been recent media accounts reporting a link between the terrorist organization Al Qaeda and the trafficking of counterfeit goods. An investigation, involving several countries, into a shipment of fake goods from Dubai to Copenhagen, Denmark, suggests that Al Qaeda itself may be funding itself by trafficking in counterfeit goods. Danish customs, using sophisticated risk analysis software, examined one of the containers on board and discovered that it contained over one thousand crates full of counterfeit shampoos, creams, cologne and perfume. The goods were ultimately bound for the United Kingdom. The United Kingdom later revealed that the sender of the counterfeit goods was a member of Al Qaeda. This connection was later confirmed by the European Commission’s Customs Coordination Office. The intelligence services of three countries—Denmark, the United Kingdom and the United States—were, according to the same report, involved in investigating the matter.<sup>11</sup>
- (4) On January 16, 2003 William Haskell Farmer entered a guilty plea to trafficking in a massive counterfeit clothing operation. (The guilty plea was conditional upon an appeal to the United States Court of Appeals for the Fourth Circuit). According to the United States prosecutor, the scheme involved approximately \$7 million in knock off T-shirts and sweat shirts. Farmer sold the shirts to 191 stores throughout the country. United States Customs agents seized over 300,000 fake items from Farmer’s home and warehouse (the house was a two-story home with a swimming pool and two car garage). Farmer agreed to forfeit over \$500,000 in cash and cashier’s checks, eight vehicles, (including two Mercedes Benzs and a 1998 Corvette), and two cargo trailers. The cash had been seized in 1998 when Farmer’s home was searched. The majority of the money was in \$50 and \$100 bills. There was \$6,000 worth of change in the garage.<sup>12</sup>
- (5) Police in the Chinatown section of New York City uncovered a stash of fake watches, handbags, sunglasses and wallets worth over \$125 million that were hidden in a building that contained secret tunnels, trapdoors and vaults. Ten people were arrested.<sup>13</sup>

<sup>9</sup> See William Glaberson, 6 Are Charged With Selling Millions of Counterfeit Marlboros, *The New York Times*, February 21, 2003, at sec. B, pg. 3; John Marzulli, Fake Marlboro Men Busted in Smuggling Ring, *Daily News (New York)*, February 21, 2003, at 37.

<sup>10</sup> See John Mintz & Douglas Farah, Small Scams Probed for Terror Ties, *Washington Post*, August 12, 2002, at A1.

<sup>11</sup> Al-Qa’idah Trading in Fake Branded Goods, *BBC Monitoring Reports* (September 11, 2002); Lenore Taylor, Big Business Targets Terrorist Pirates, *Australian Financial Review*, January 29, 2003, at 9.

<sup>12</sup> Cliff LeBlanc, Huge Fake Clothing Ring Cracked, Upstate Man Pleads Guilty to Running \$7 Million Scam, *The State (South Carolina)*, January 18, 2003, at A1; South Carolina Man Pleads Guilty to Trafficking Clothing with Counterfeit Trademarks, *Department of Justice Press Release*, January 16, 2003, available at <http://www.cybercrime.gov/farmerPlea.htm>.

<sup>13</sup> Erika Martinez & Marsha Kranes, Knockoffs Knocked Out, *New York Post* (May 10, 2002).

- (6) In November 2001, US federal authorities made their largest seizure ever of counterfeit computer software in connection with the arrest of the individuals. The seizure of nearly 31,000 copies of phony software was valued at approximately \$100 million (US). The software originated in Taiwan and was encased in counterfeit packaging (including holographs and registration codes) and also came with manuals. Federal authorities were alerted to the shipment when a member of a criminal syndicate operating between Taiwan and Los Angeles allegedly attempted to bribe an undercover agent who was posing as a U.S. Customs official. Seized in connection with the arrests were a forty foot shipping container containing counterfeit computer software and packaging material, two forty foot containers filled with 85,000 cartons of counterfeit cigarettes (i.e., 17 million cigarettes). A second search warrant executed in connection with the investigation resulted in the seizure of 21 cartons of counterfeit end user license agreements, manuals, bar codes, adhesive labels and registration cards.<sup>14</sup>

These are just a few examples. For more stories about the well documented links between intellectual property theft and organized crime and terrorism, please refer to the attached document containing a list of relevant public source news articles and government reports compiled by the IACC.

The IACC believes that the best deterrent to counterfeiting and piracy is criminal penalties that result in actual imprisonment. Based on this policy, the IACC has led efforts that resulted in the passage of the 1984 Trademark Act that established federal criminal sanctions for trademark counterfeiting,<sup>15</sup> the Anticounterfeiting Consumer Protection Act of 1996 that increased civil penalties and provided U.S. Customs with the authority to assess administrative fines against those that import counterfeit products,<sup>16</sup> and the establishment of specific criminal provisions for trademark counterfeiting in 31 states and the District of Columbia. By providing federal and state law enforcement officials with the jurisdiction to prosecute counterfeiters, and U.S. Customs with the discretion to penalize known importers of counterfeit merchandise, the IACC has sought to promote a comprehensive enforcement system to stop illegal goods at the borders, punish manufacturers and distributors of counterfeit products in interstate commerce, and address counterfeiting at the retail level within the states, counties and cities where it is most prevalent.

Recent world events have caused federal and state government officials to correctly reevaluate the mission priorities of law enforcement personnel to address national security issues. As pointed out above, the IACC is concerned that the low risk, high-profit nature of counterfeiting and piracy has and will continue to attract the attention of organized crime and terrorist groups looking to fund their operations. The IACC and its members look forward to working with Congress, law enforcement and the new Department of Homeland Security to identify and eliminate links between counterfeiting and the funding of terrorist groups that may arise in the course of protecting U.S. economic interests and intellectual property rights.

#### CONCLUSION

On behalf of the IACC, I thank the Members of the Subcommittee for providing me with the opportunity to present this written testimony and, based on the documented links I have presented herein, urge the United States Government to investigate more aggressively the links between all types of intellectual property theft and organized criminal and terrorist groups.

<sup>14</sup>Taiwan Fears US Blacklist After Fake Software Haul, The Strait Times (Singapore), November 19, 2001, at A3; U. S Customs Seizes \$100 Million in Pirated Computer Software, Biggest Case in U.S. History, Department of Justice Press Release, November 16, 2001, available at <http://www.cybercrime.gov/operationwhitehorse.htm>.

<sup>15</sup>See 18 U.S.C. § 2320.

<sup>16</sup>See 19 U.S.C. § 1526(f).



# FACTS ON FAKES

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## Introduction

Mr. James Moody, former chief of the Federal Bureau of Investigation's Organized Crime/Drug Operations Division declared that counterfeiting would become "the crime of the 21<sup>st</sup> century."

-- George W. Abbott, Jr. and Lee S. Sporn, *Trademark Counterfeiting* § 1.01 (2001).

The DOJ's own prosecution guidelines for intellectual property offenses contain the following pertinent passage:

*The importance of intellectual property to the national economy, and the scale of intellectual property theft, led the Department of Justice to designate intellectual property crime as a "priority" for federal law enforcement. As the U.S. Attorneys' Manual recognizes, "from time to time the Department establishes national investigative and prosecutorial priorities. These priorities are designed to focus Federal law enforcement efforts on those matters within the Federal jurisdiction that are most deserving of Federal attention and are most likely to be handled effectively at the Federal level." U.S. Attorneys' Manual 9-27.230(B)(1) (comment).*

*Intellectual property crimes were formally designated a "priority" by Deputy Attorney General Eric Holder on July 23, 1999. Deputy Attorney General Eric Holder, Remarks at Press Conference Announcing the Intellectual Property Rights Initiative (Jul. 23, 1999) (<http://www.cybercrime.gov/dagipini.html>). In announcing the Intellectual Property Rights Initiative, Deputy Attorney General Holder stated that the Department of Justice, the Federal Bureau of Investigation and the United States Customs Service had concluded that they must make investigating and prosecuting intellectual property crime "a major law enforcement priority." In making the announcement, he noted that:*

*[a]s the world moves from the Industrial Age to the Information Age, the United States' economy is increasingly dependent on the production and distribution of intellectual property. Currently, the U.S. leads the world in the creation and export of intellectual property and IP-related products.*

*Deputy Attorney General Holder also observed that "[a]t the same time that our information economy is soaring, so is intellectual property theft." Since intellectual property theft undermines the federally established copyright and trademark systems, it is especially appropriate that investigation and prosecution of these crimes be a federal law enforcement priority.*

-- United States Department of Justice Prosecuting Intellectual Property Crimes Manual <http://www.usdoj.gov/criminal/cybercrime/ipmanual/06ipmanual.htm#VI.A.1.g>. (Section six of this manual is entitled: Charging and Other Strategy Considerations for Infringement Cases). The manual was drafted by the Computer Crime and Intellectual Property Section (CCIPS) of the Department of Justice and the entire manual can be accessed at <http://www.usdoj.gov/criminal/cybercrime/ipmanual.htm>.

### **Economic Impact of Counterfeiting**

*The size and scope of product counterfeiting has skyrocketed in recent years. The United States economy is losing millions of dollars in tax revenue and tens of thousands of jobs because of the manufacture, distribution and sale of counterfeit goods. This decrease in revenue results in fewer schools, hospitals, police, roads, etc. The actions of counterfeiters also make it harder for legitimate retailers to compete in the marketplace. Counterfeiting results in decreased retail sales and lost jobs as honest intellectual property owners are forced to cut back work forces because of decreased sales. Counterfeiters are not innocent little con artists or isolated street peddlers simply trying to make a few extra dollars. The truth is they steal from the corporations, steal from the community, steal from the consumers they deceive and are only concerned with lining their own pockets.*

(1) The Business Software Alliance estimates the cost of software piracy alone to be about \$12 billion a year.

(2) The International Chamber of Commerce estimates that seven percent of the world trade is in counterfeit goods and that the counterfeit market is worth \$ 350 billion. George W. Abbott, Jr. and Lee S. Sporn, *Trademark Counterfeiting* § 1.03[A][2] (2001).

(3) In 1982 the International Trade Commission estimated counterfeiting and piracy losses at 5.5 billion. In 1996, that number stood at \$200 billion. (Bank robberies, by contrast, involve less than \$50 million per year, but seem to garner more public attention and more law enforcement resources). -- *S. Rep. No. 104-177, 104<sup>th</sup> Cong., 1st Sess. 1-2 (1995)*; George W. Abbott, Jr. and Lee S. Sporn, *Trademark Counterfeiting* § 1.03[A][2] (2001).

(4) Counterfeit automobile parts, like brake pads, cost the auto industry alone over \$12 billion dollars in lost sales. If these losses were eliminated the auto industry could hire 200,000 additional workers. George W. Abbott, Jr. and Lee S. Sporn, *Trademark Counterfeiting* § 1.03[A][2] (2001); Richard C. Noble, *From Brakes to Plugs to Engines. Counterfeiters Produce, Push Parts*. Flint J., September 3, 1995; H.R. Rep. No. 104-556 (1996), reprinted in 1996 U.S.C.A.N. 1074, 1075.

(5) Lost tax revenue costs New York City alone approximately \$350 million a year in lost revenue -- *Joseph Scott, He Is the Fashion Police, New York, March 6, 1995, at 38*. According to a 1993 Business Wire release, product counterfeiting is believed to cost

California \$7.5 billion a year and 25, 000 jobs. In Michigan, a piracy rate of 14.7% translates into \$64.7 million in retail losses and \$34.9 million in lost tax revenue. *BSA Seeks to Sink Software Pirates*, Grand Rapids Business Journal, vol. 20, No. 18, pg. 3 (May 6, 2002).

### **Organized Crime/Terrorism & Counterfeiting – Examples**

*Low risk of prosecution and enormous profit potential have made criminal counterfeiting an attractive enterprise for organized crime groups. Congress recognized organized crime's increasing role in the theft of intellectual property when it made trademark counterfeiting and copyright piracy predicate acts under the federal RICO statute (see 18 U.S.C. § 1961). Recently, ties have been established between counterfeiting and terrorist organizations who use the sale of fake goods to raise and launder money. Consider these facts about the presence of organized criminal and terrorist groups in the underground counterfeiting and piracy markets:*

(1) Operation Green Quest -- a multi-agency task force established by the Treasury Department and aimed at identifying, disrupting and dismantling the terrorist financial infrastructure and sources of funding -- has specifically recognized counterfeit merchandise schemes as a source of terrorist funding. *Green Quest, Finding the Missing Piece of the Terrorist Puzzle*, available at [http://www.customs.usdtreas.gov/xp/cgov/enforcement/investigative\\_p/civitics/greenquest.xml](http://www.customs.usdtreas.gov/xp/cgov/enforcement/investigative_p/civitics/greenquest.xml).

(2) In February 2003, federal prosecutors in Brooklyn, NY charged six men with importing up to 35 million counterfeit cigarettes from China into the United States. The men were accused of importing the fake cigarettes, then selling them through a tax free business located at an upstate New York Indian reservation and also through the website <http://www.smokecheap.com>. The cigarettes were allegedly imported into the United States in 5 separate shipments through New Jersey ports over a two year period. The charging documents stated that the counterfeiters hid the cigarettes in shipping containers behind kitchen pots. According to the prosecutors, the men were under investigation in Europe for cigarette smuggling. Two of the defendants were also charged with importing counterfeit batteries from China via Lithuania. William Glaberson, *6 Are Charged With Selling Millions of Counterfeit Marlboros*, The New York Times, February 21, 2003, at sec. B, pg. 3; John Marzulli, *Fake Marlboro Men Busted in Smuggling Ring*, Daily News (New York), February 21, 2003, at 37.

(3) On February 28, 2003, Mohamad Hammoud was sentenced to 155 years in prison for helping to lead a cigarette smuggling operation that sent money to Hezbollah. *Ringleader Gets Maximum Sentence in Scheme to Help Hezbollah*, available at <http://www.foxnews.com/story/0,2933,79909,00.html>.

(4) In the Philippines, underground CD production lines are often heavily secured sites equipped with hidden cameras for early detection and surveillance purposes. Syndicates move the equipment in piece by piece to avoid detection. Dave L. Llorito, *Loose Rules Make CD Pirates Feel at Home Here*, The Manila Times (January 2, 2003)(a three part article); *Lax Rules Give CD Pirates a New Home in the Philippines*, The Straits Times (January 6, 2003).

(5) There have been recent media accounts reporting a link between the terrorist organization Al Qaeda and the trafficking of counterfeit goods. An investigation, involving several countries, into a shipment of fake goods from Dubai to Copenhagen, Denmark, suggest that Al Qaeda itself may be funding itself by trafficking in counterfeit goods. Danish customs, using sophisticated risk analysis software, examined one of the containers on board and discovered that it contained over one thousand crates full of counterfeit shampoos, creams, cologne and perfume. The goods were ultimately bound for the United Kingdom. The United Kingdom later revealed that the sender of the counterfeit goods was a member of Al Qaeda. This connection was later confirmed by the European Commission's Customs Coordination Office. The intelligence services of three countries -- Denmark, the United Kingdom and the United States -- were, according to the same report, involved in investigating the matter. -- *Al-Qa'idah Trading in Fake Branded Goods*, BBC Monitoring Reports (September 11, 2002); Lenore Taylor, *Big Business Targets Terrorist Pirates*, Australian Financial Review, January 29, 2003, at 9.

(6) On January 16, 2003 William Haskell Farmer entered a guilty plea to trafficking in a massive counterfeit clothing operation. (The guilty plea was conditional upon an appeal to the United States Court of Appeals for the Fourth Circuit). According to the United States prosecutor, the scheme involved approximately \$7 million in knock off T-shirts and sweat shirts. Farmer sold the shirts to 191 stores throughout the country. United States Customs agents seized over 300,000 fake items from the Farmer's home and warehouse (the house was a two-story home with a swimming pool and two car garage). Farmer agreed to forfeit over \$500,000 in cash and cashier's checks, eight vehicles, (including two Mercedes Benzs and a 1998 Corvette), and two cargo trailers. The cash had been seized in 1998 when Farmer's home was searched. The majority of the money was in \$50 and \$100 bills. There was \$6,000 worth of change in the garage. Clif LeBlanc, *Huge Fake Clothing Ring Cracked. Upstate Man Pleads Guilty to Running \$7 Million Scam*, The State (South Carolina), January 18, 2003, at A1; *South Carolina Man Pleads Guilty to Trafficking Clothing with Counterfeit Trademarks*, Department of Justice Press Release, January 16, 2003, available at <http://www.cybercrime.gov/farmerPlea.htm>.

(7) Counterfeit operations in Paraguay tri-border region may have been used to raise money to support terrorist operations and groups. *Feds Track Counterfeit Goods Sales*, available at: [http://abcnews.go.com/wire/US/ap20021024\\_151.html](http://abcnews.go.com/wire/US/ap20021024_151.html), (October 24, 2002); Kathleen Millar, *Financing Terror*, U.S. Customs Service Monthly Newsletter, November 2002, available at <http://www.customs.gov/custoday/nov2002/index.htm>; Larry Rother, *South America Region Under Watch for Signs of Terrorists*, The New York



Times, December 15, 2002, at 32; Sebastian Junger, *Terrorism's New Geography*, Vanity Fair, December 2002. The first article cited states:

*"Federal authorities have several investigations under way examining evidence suggesting that Hezbollah, Hamas and other terror networks might be selling counterfeit products to pay for their worldwide activities. . . . FBI, Customs Service and other agencies are investigating the sale of stolen or counterfeit computer software, T-shirts and handbags that are suspected of benefiting terrorist networks. Officials said the schemes span the globe from Paraguay to Pakistan . . . . U.S. officials said there is particular concern that a region in South America famous for counterfeit products may have ties to terrorism. The region near the borders of Paraguay, Brazil and Argentina has a large Arab population. Law enforcement officials said they are investigating multimillion-dollar counterfeit software operations based in Ciudad Del Este, in eastern Paraguay, that are believed to have diverted money to Middle Eastern groups with ties to terrorism. Some of the suspects are of Lebanese origin and were arrested by Paraguayan authorities based on information from the U.S. government, the officials said."*

(8) A 52 year old woman was one of four people arrested in November 2001 after being suspected of operating a piracy ring that imported close to \$100 million in fake software and computer products from Taiwan. The woman was recently sentenced to nine years in prison and ordered to pay \$11 million in restitution to two software companies. *Woman Must Pay \$11m in Software*, <http://www.cnn.com/2002/TECH/biztech/11/25/counterfeit.software.ap/index.html>, November 25, 2002.

(9) According to some media reports, the FBI had compiled strong evidence that the 1993 terrorists financed their activities with counterfeit textile sales from a store on Broadway. James Nurton, *Why Counterfeiting is Not So Harmless*, Managing Intellectual Property, September 2002, at 43; *Feds Track Counterfeit Goods Sales*, at [http://abcnews.go.com/wire/US/ap20021024\\_151.html](http://abcnews.go.com/wire/US/ap20021024_151.html) (October 24, 2002)(noting that testimony before a Senate Judiciary Committee in 1995 confirmed this fact). In 1996, *Business Week* reported that the FBI had investigated the link between counterfeit merchandise sales in New York and the terrorists who bombed the World Trade Center in 1993. Willy Stern, *Why Counterfeit Goods May Kill*, *Business Week*, September 2, 1996, at 6.

(10) According to the private investigator conducting the search, a raid of a souvenir shop in mid-town Manhattan led to the seizure of a suitcase full of counterfeit watches and the discovery of flight manuals for Boeing 767s, some containing handwritten notes in Arabic. A similar raid on a counterfeit handbag shop in New York uncovered faxes relating to the purchase of bridge inspection equipment. Two weeks after the raid on the handbag shop, police in New Jersey were investigating an assault on a Lebanese member of an organized crime syndicate. During a search of the man's apartment, authorities

found fake drivers' licenses and lists of suspected Al Qaeda terrorists – including the names of some workers in the handbag shop that had been raided. James Nurton, *Why Counterfeiting is Not So Harmless*, Managing Intellectual Property, September 2002, at 43.

(11) Paramilitary groups in Northern Ireland funded their terrorist activities through the sale of pirate products, including the sale of the Lion King. -- Kathleen Millar, *Financing Terror*, U.S. Customs Service Monthly Newsletter, November 2002, available at <http://www.customs.gov/custoday/nov2002/index.htm>; Nick Somerlad, *Two Arrested After Police Find Explosives*, Press Association, December 20, 2000.

(12) In July 2002, three individuals were arrested when police stumbled upon 5,000 fake Rolex watches and Mount Blanc pens and \$1 million in cash during a raid of a Flushing (Queens), New York home in connection with a drug operation. Prosecutors stated that the defendants used the sale of counterfeit items to launder drug money. Scott Shifrel, *3 Charged in Money Laundering*, Daily News (New York), July 11, 2002, at 4.

(13) Recovered Al Qaida terrorist training manuals revealed that the organization recommends the sale of fake goods as one means to raise funds to support terrorist operations. John von Radowitz, *Fake Internet Goods 'Linked to Terrorists'*, Press Association, June 25, 2002. This same article noted that Hezbollah traffics in counterfeit pharmaceuticals. John von Radowitz, *Fake Internet Goods 'Linked to Terrorists'*, Press Association, June 25, 2002.

(14) The Basque terrorist group ETA in southern Spain is involved in the sale of counterfeit clothes and handbags. John von Radowitz, *Fake Internet Goods 'Linked to Terrorists'*, Press Association, June 25, 2002.

(14) Police in the Chinatown section of New York City uncovered a stash of fake watches, handbags, sunglasses and wallets worth over \$125 million that were hidden in a building that contained secret tunnels, trapdoors and vaults. Ten people were arrested. -- Erika Martinez & Marsha Kranes, *Knockoffs Knocked Out*, New York Post (May 10, 2002).

(15) In February 2002, John Sankus Jr., 28, of Philadelphia, was sentenced to 46 months in prison leading an international piracy ring responsible for copying and distributing software, games and movies. Sankus headed an international software piracy group called DrinkorDie, which was comprised of about sixty members from numerous countries including the United States, Australia, Norway, Finland and the UK. The group's biggest claim to fame was distributing copies of Windows 95 two weeks before the official release of the operating system. Federal agents conducted raids at Duke University and MIT in connection with DrinkorDie's activities. Some of the computers seized in the operation contained more than one terabyte of hacked software (which is equal to 700,000 floppy disks). -- Josh White, *Pa. Man Admits Internet Conspiracy*, Washington Post, at B02, (February 28, 2002).

(16) On December 14, 2001, Mark Dipadova (who used three aliases) was sentenced to 24 months in prison and three years of supervised release and ordered to pay over \$135,000 in restitution for operating websites through which he sold counterfeit goods. Dipadova and his partner shipped over 10,000 packages, both domestically and internationally and had been sued civilly by trademark holders. At his sentencing hearing, Dipadova admitted to posting a link on one of his websites to an audio recording of a radio interview in which he stated that he was aware that his actions were illegal but that he refused to stop because he was making too much money. *Defendant Who Operated Fakegifts.com Sentenced*. Department of Justice Press release, December 17, 2001, available at <http://www.cybercrime.gov/DipadovaSent.htm>.

(17) In November 2001, US federal authorities made their largest seizure ever of counterfeit computer software in connection with the arrest of the individuals. The seizure of nearly 31,000 copies of phony software was valued at approximately \$100 million (US). The software originated in Taiwan and was encased in counterfeit packaging (including holographs and registration codes) and also came with manuals. Federal authorities were alerted to the shipment when a member of a criminal syndicate operating between Taiwan and Los Angeles allegedly attempted to bribe an undercover agent who was posing as a U.S. Customs official. Seized in connection with the arrests were a forty foot shipping container containing counterfeit computer software and packaging material, two forty foot containers filled with 85,000 cartons of counterfeit cigarettes (i.e., 17 million cigarettes). A second search warrant executed in connection with the investigation resulted in the seizure of 21 cartons of counterfeit end user license agreements, manuals, bar codes, adhesive labels and registration cards. *Taiwan Fears US Blacklist After Fake Software Haul*, The Strait Times (Singapore), November 19, 2001, at A3; *U. S Customs Seizes \$100 Million in Pirated Computer Software. Biggest Case in U.S. History*. Department of Justice Press Release, November 16, 2001, available at <http://www.cybercrime.gov/operationwhitehorse.htm>.

(18) The speed and brazenness of Italian counterfeiting groups was demonstrated the summer of 2001 when burglars broke into the headquarters of a prominent Italian luxury goods/apparel producer. An investigation of the incident revealed that the only items missing as a result of the break-in were samples of the designer's 2002 men's spring/summer collection. It is now assumed that counterfeiters stole the samples to copy them before the genuine products made it to market. The sale of fake leather goods alone in Italy is estimated at \$1.4 billion. Robert Galbraith, *Luxury Groups Battle a Wave of Counterfeit Goods*, *The International Herald Tribune*, p. 12 (September 29, 2001).

(19) In November 2001, a Cocoa Florida businessman was convicted of conspiracy to distribute and possession of cocaine and crack cocaine, trafficking in counterfeit merchandise and carjacking. When he was arrested police seized \$150,000 in cash and truckloads of counterfeit clothing. -- John Tuohy, *Testimony from Felons Help Convict Cocoa Man*, Florida Today, (November 27, 2001).

(20) In 1996, the FBI confiscated 100,000 counterfeit T-shirts bearing fake and unauthorized Nike "swoosh" and/or Olympic logos that were intended to be sold at the

1996 summer Olympic games in 1996. The operation generated millions of dollars and was run by the followers of Sheik Omar Abdel Rahman – a blind cleric who was sentenced to 240 years in prison for plotting to bomb New York City landmarks. -- John Mintz & Douglas Farah, *Small Scams Probed for Terror Ties*, Washington Post, August 12, 2002, at A1. Authorities seized three floors worth of illicit merchandise, stacked seven feet high.

(21) In 1993, law enforcement officials in New York raided a large warehouse in New York and discovered numerous fake handbags. What was unusual was what they found sewn into the lining of the handbags. The ring of drug smugglers would smuggle in the drugs this way, sell the drugs and then sell the bags. Essentially, they used contraband to hide other contraband. George W. Abbott, Jr. and Lee S. Sporn, *Trademark Counterfeiting* § 1.03[B] (2001); S. Rep. 104-177, 104<sup>th</sup> Cong., 1<sup>st</sup> Sess. (1995).

## Health & Safety Concerns/Dangers

*"Perhaps most troubling is the widespread threat counterfeiting poses to public health and safety. Few Americans truly appreciate the significance, scope or consequences for this crime."*

Senator Orrin G. Hatch (R-UT)  
Chairman, Senate Judiciary Committee  
Press Conference, August 9, 1995

(1) A survey conducted by the Nigerian Institute of Pharmaceutical Research revealed that 80 percent of drugs in the major pharmacy stores in Lagos, Nigeria were fake or counterfeit. *Nigeria Reaffirms Efforts to Eliminate Fake Drugs*, Xinhua General News Service, February 13, 2003.

(2) According to the Shenzhen Evening News (a government owned newspaper), approximately 192,000 people died in China in 2001 because of fake drugs. *China's Killer Headache: Fake Pharmaceuticals*, Washington Post, August 30, 2002. The same article goes on to state that, since 2001, Johnson & Johnson has established 38 criminal cases against different factories that copied its products in China.

(3) Diet pills imported into Japan (from China) were blamed for at least four deaths and 160 cases of illness. Dozens of people were suffering from liver disorders. -- *Chinese Diet Pill Casualties Mount*, <http://www.cnn.com/2002/WORLD/asiapcf/east/07/21/japan.pills/index.html>, July 21, 2002.

(4) According to a federal indictment made public in 2002, U.S. Customs officials seized 59,000 bottles of counterfeit vodka in a Massachusetts warehouse. It had been imported from a former Soviet republic. Thanassis Cambanis, *Fancy Labels, Cheap Vodka Don't Mix*, The Boston Globe, May 2, 2002, at B1.

(5) In August 2002, Bell Helicopter sued two aircraft maintenance and repair companies for trademark counterfeiting. -- James E. Swickard (editor), *Bell Helicopter is Suing Two Companies Specializing in Aircraft Maintenance and Repair*, Business & Commercial Aviation, Vol. 91, No. 2, p. 33 (Intelligence Section)(August 2002).

(6) In New York it was discovered that a 16 year old liver transplant recipient had received eight weeks worth of injections of a counterfeit drug (Epogen) to treat his anemia and raise the child's red blood cell count. The treatments, instead of improving the boy's condition, caused excruciating aches and spasms. The vials used for the injections were supposed to contain 40,000 units of the drug, instead the counterfeit version contained only 2,000 units. Other counterfeit lots were found in Texas. --- Ridgely Ochs, *Sounding Alarm on Counterfeit Drugs; FDA Investigating Recent of Fake Drug Cases*, New York Newsday, at 6 (June 12, 2002).

(7) Other counterfeit drug cases include a meningitis vaccine made of tap water, birth control pills made of wheat flour, and paracetamol syrup made of industrial solvents. The Engineer, *Fighting the Fakers*, April 26, 2002, at 16; House Report of the Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, *Prescription Drug Diversion and Counterfeiting*, July 10, 1985, at 23 (referring to a scam involving counterfeit birth control pills).

(8) In 2002, a New York County district attorney charged seven people and five companies in the US, China and India with selling counterfeit Viagra over the Internet. Undercover officers purchased over 25,000 pills. Some pills were smuggled into the U.S. in stereo speakers and stuffed toys. One supplier told the agents that he could supply 2.5 million tablets a month. Counterfeits hit market within two weeks. -- *U.S. Officials Arrest Viagra Counterfeiters*, Scrip, May 22, 2002; Ridgely Ochs, *Sounding Alarm on Counterfeit Drugs; FDA Investigating Recent of Fake Drug Cases*, New York Newsday, at 6 (June 12, 2002).

(9) In 2001, illicit vodka containing methyl alcohol killed 60 people in Estonia. The Engineer, *Fighting the Fakers*, at 16 (April 26, 2002).

(10) Counterfeit version of the AIDS drug circulated in the US in late 2000; the drug was not effective and caused skin irritations. -- The Engineer, *Fighting the Fakers*, April 26, 2002, at 16; Jim Shamp, *Glaxo Sends Out Warning About AIDS Drug*, The Herald-Sun, May 14, 2002 (discussing a case of counterfeit labels applied to the wrong type of AIDS drug).

(11) Seventeen people in the US died between May 1999 and January 2000 after taking a powerful, but counterfeit, antibiotic. The Engineer, *Fighting the Fakers*, at 16 (April 26, 2002).

(12) World Health Organization estimates that counterfeit drugs account for ten percent of all pharmaceuticals. That number can rise to as high as 60% in developing

countries. The Engineer, *Fighting the Fakers*, at 16 (April 26, 2002); Phillippe Broussard, *Dangerous Fakes*, World Press Review, v44, n1, p36 (1) (January 1999).

(13) An August 2001 news article reported a host of actions by the Saudi Arabian Ministry of Commerce against distributors attempting to sell potentially unhealthy products. Among the unhealthy products seized were 7,000 bottles of imitation Vaseline and related fake creams found while investigating cosmetic shops. A November 2001 raid at a counterfeit factory in Jeddah resulted in the seizure of 10,000 packets of jelly, 650,000 packets of macaroni, 12,000 bottles of perfume, and 5,000 brake pads. The factory employed 120 workers who were involved in producing fake cardboard cartons, cans and bottles.

(14) Over 100 children died in Nigeria in 1990 after taking cough syrup that was actually antifreeze. Phillippe Broussard, *Dangerous Fakes*, World Press Review, v44, n1, p36 (1) (January 1999).

(15) Counterfeit versions of infant formula were found on the shelves of grocery stores in 16 different states. Marian Burros, *F.D.A. Target: Baby Formula*, N.Y. Times, September 6, 1995; 142 Cong. Rec. 5776 (House). More recently, in 1999, the Food and Drug Administration (FDA) issued a warning regarding counterfeit cans of infant formula for infants allergic to milk protein. The warning came after some of the illicit product had already been purchased. The FDA warning stated that infants who ingested the counterfeit formula could experience fevers, skin rashes or severe allergic reactions. *FDA Warns About Infant Formula Fraudulently Labeled as Nutramigen in Southern California*, HHS NEWS (U.S. Department of Health and Human Services), P99-23, October 8, 1999. See also *Fugitive Who Sold Counterfeit Baby Formula Convicted of Federal Criminal Charges*, Department of Justice (Press Release), August 9, 2002, available at <http://www.cybercrime.gov/mostafaConvict.htm> (discussing the conviction of Mohamad Mostafa on charges involving a conspiracy to sell counterfeit infant formula; the defendant was also in the country illegally and upon indictment in 1995 fled to Canada where he was arrested in 2001).

(16) One counterfeiter in California filled genuine Coke bottles with his own soda like beverage and offered them for sale as genuine Coca-Cola. *United States v. Petrosian*, 126 F.3d 1232 (9<sup>th</sup> Cir. 1997).

(17) Counterfeit parts have been discovered in helicopters sold to NATO, in jet engines, bridge joints, and fasteners in areas of nuclear facilities responsible for preventing the meltdown of the reactor itself. H.R. Rep. 104-556 (1996).

(18) In the mid 1990s a major shampoo producer was forced to place newspaper ads in over 25 papers to warn consumers to the presence of fake shampoos that contained unsafe levels of bacteria. Henry Gilgoff, *Counterfeit: Rip-offs of Popular Products Victimize Both Consumers and Manufacturers*, Newsday, August 27, 1995. Fake toothpaste has also found its way into drug stores. *Colgate Warns People Against Fake Toothpaste*, Austin American Statesman, August 12, 1996.

(19) A Norwegian plane crash in 1989 that killed 55 people resulted, in part, from substandard shear bolts and sleeves of an unknown origin. *55 Killed in Crash of Norwegian Plane, None Aboard Survive as Craft Plunges into Sea Near Denmark*, L.A. Times, September 9, 1989, at 4 (cited and discussed in Robert W. Luedeman, *Flying Underground: The Trade in Bootleg Aircraft Parts*, 62 J. Air L. & Comm. 9396-100 (August/September 1996)).

(20) The FAA estimates that 2% of the 26 million airline parts installed each year are counterfeit (that equals 520,000 parts). Billy Stern, *Warning! Bogus Parts Have Turned Up in Commercial Jets. Where's the FAA?*, Business Week, June 10, 1996, at 90.

(21) The operational life of counterfeit bearing seal spacers removed from a United Airlines plane were found to be 600 hours - - the genuine parts had an operational life of 20,000 hours - - the fake parts came complete with fake boxes, labels and paperwork and were only discovered because of a vigilant airline mechanic. In another case, Delta Airlines discovered that an engine mount cone-bolt, (a device which actually fastens the engine to the plane), on one of its planes was actually counterfeit. Billy Stern, *Warning! Bogus Parts Have Turned Up in Commercial Jets. Where's the FAA?*, Business Week, June 10, 1996, at 90.

(22) In 1987, seven children died when the bus they were riding in flipped over. The brakes that were just installed on the bus bore a well-known trademark. Further examination, however, showed they were made of sawdust. *A System Approach to the Counterfeit Problem, Genuine or Bogus: How Can You Tell?*, ASTM Standardization News, April 1990, at 38.

(23) In a federal case in California the court determined the defendant sold counterfeit helicopter parts that caused several helicopters to crash resulting in injuries and death. S. Rep. No. 98-526 at 4 (1984), *reprinted in* 1984 U.S.C.C.A.N. 3627, 3630-31.

(24) One million counterfeit birth control pills caused internal bleeding in women. S. Rep. No. 98-526 at 4 (1984), *reprinted in* 1984 U.S.C.C.A.N. 3627.

